

***United States Court of Appeals
for the Second Circuit***



APPENDIX

77-7104

United States Court of Appeals

For the Second Circuit

DAVID E. ROLF,
Plaintiff-Appellant-Cross-Appellee,
against

BLYTH, EASTMAN DILLON & CO., INC.,
and MICHAEL STOTT,
Defendants-Appellees-Cross-Appellants,

and

AKIYOSHI YAMADA,
Defendant.

On Appeal from an Order and Judgment of the
United States District Court for the
Southern District of New York

JOINT APPENDIX VOLUME I OF THREE VOLUMES (Pages JA1 to JA320)

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~~73 JAN 20 1967~~

TITLE OF CASE

ATTORNEYS

DAVE E. ROLF

For plaintiff:

550

CELTIC, EASTMAN DILLON & CO. INCORPORATED,
ANTHONY ZAMBA AND - 2-3-76.
MICHAEL STONE.

Silverman & Harnes

75 Rockefeller Plaza N.Y.C. 10019 765-7884

For defendant:

Feiner Curtis Smith & Goldman (deft. Yamada)
919 Third Avenue, NYC 10022 -355-2300 -

Breed Abbott & Morgan (all depts. except Yam
1 Chase Manhattan Plaza, NYC 10005 - 944-4

STATISTICAL RECORD	COSTS	DATE	NAME OR RECEIPT NO.	REC.	DISB.
J.S. 5 mailed X	Clerk	7/5/23	Elmer + 1/2	15-	
		7/10/23	1/5		
J.S. 6 mailed 22-02-77	Marshal				
Basis of Action:	Docket fee				
S.E.C.A. CT. 1933 & 34	Witness fees				
Action arose at:	Depositions				

33 CIV 2957

DATE	PROCEEDINGS	Date Made Judgment
Jul 5-73	Filed Complaint. Issued Summons.	
Jul 23-73	Filed Summons and marshals ret. Served: Blyth Eastman Dillon & Co., on 7/10/73 Akiyoshi Yamada on 7/13/73 Michael Stott on 7/10/73	
Aug-2-73	Filed Deft. Akiyoshi Yamada ANSWER.	
Aug-29-73	Filed Stip & Order that the time for defts. Blyth Eastman Dillon & Co. Inc. & Michael Stott to answer to complaint is extended to 9/5/73. Pierce J.	FOREG
Sep-10-73	Filed ANSWER OF DEFTS. to Cross Claim of Akiyosi Yamada.	BAM
Sep-10-73	Filed defts(Blyth Eastman Dillon & Co and Michael Stott) ANSWER AND CROSS CLAIM.	B.A. &
Sep-21-73	Filed pltf's Notice to Produce Documents.	
Oct-24-73	Filed Defts. Blyth Eastman Dillon & Co., Inc. & Michael Stott response to notice to produce documents.	
Dec-12-73	Filed Pltffs. Notice of Motion. REX Re: Compel Discovery. ret. 12/20/73	
Dec-12-73	Filed Memorandum of law in support of pltf's motion for an order compelling discovery.	
Dec-19-73	Filed Affidavit in opposition by Mar Skolnick in opposition to Pltff's motion compelling discovery.	
Dec-19-73	Filed Response to Notice to produce documents.	
Jan. 29-74	Filed memo endorsed on motion filed 12-12-74(Rule 37a)Pltff's motion for an order compelling discovery is hereby referred to Magistrate Hartenstine to hear and recommend. So Ordered---Pierce, J. mailed notices.	
Mar. 8-74	Filed memo endorsed on motion filed 12-12-73--The deft. Yamada file an affdvt indicating the disposition of any documents called for by notice to produce. Defts. counsel to pay the costs of the motion, including pltf's attys fees, in the sum of \$250.---So Ordered--Pierce, J. Mailed notices.	
Apr 23-74	Filed Affidavit by Akiyosi Yamada	
May 27-74	<i>Pre Trial Conference held</i>	
May 30-74	Filed order of referral to Magistrate Goettel--Pierce, J.	
May 31-74	Filed notice of change of address of pltf's atty.	
Jun 13-74	Filed Pltffs. Notice of Motion & Affidavit in support. Re: Deposition of Deft. Akiyoshi Yamada, ret. 6/18/74. <i>sent to mag. Goettel</i>	
Jun 13-74	Filed Pltffs. Memorandum of Law.	
Jun 20-74	Filed Report & Recommendations of Magistrate Goettel	
Jun 24-74	Filed Affidavit in opposition by Mark Skolnick to pltffs. motion for leave to take deposition of deft. Akiyoshi Yamada.	
7-10-74	PRE-TRIAL CONFERENCE HELD BY <i>Goettel</i>	
Jul 11-74	Filed Memo. End. on motion drd. 6/3/74. Motion withdrawn without prejudice. So Ordered Pierce J. (mailed notice)	
Jul 22-74	Filed Pltff's notice of taking deposition of Deft. Michael Stott on 7-25-74.	
Jul 22-74	Filed Pltff's interrogs. to Deft Yamada.	
7-23-74	PRE-TRIAL CONFERENCE HELD BY <i>Goettel</i>	
ep 25-74	Filed Defts. Blyth Eastman Dillon & Co. & Michael Stott Notice of Deposition of pltf. on 10/10/74.	
ov. 6-74	Filed pltf's answers to documentary request to produce.	
7-8-74	PRE-TRIAL CONFERENCE HELD BY <i>Goettel</i>	
ov. 29-74	Filed defts' (Blyth Eastman) interrogs.	
in. 17-75	Filed pltf's answers to interrogs. of Redco's & Stott	
7-22-75	PRE-TRIAL CONFERENCE HELD BY <i>Goettel</i>	
3-5-75	PRE-TRIAL CONFERENCE HELD BY <i>Goettel</i>	
Apr. 10-75	Filed pre-trial stip. & order--Pierce, J.	
Apr. 10-75	Filed defts' (Blyth Eastman et ano) pre-trial memorandum	
7-24-75	Filed defts Blyth Eastman Dillon & M Scott proposed findings of fact and conclusions of law.	

CONT TO PG 3

NOV 1967 DATED 23 1976 VS BLYTH EASTMAN DILLON, ET-ALNO

JUDGE PIERCE

DATE	PROCEEDINGS
3-24-76	Filed Pre Trial memo of Law submitted on behalf of depts Blyth Eastman Dillon & Co. and Michael Scott, as indicated.
4-1-76	Filed pliffs proposed findings of fact and conclusions of law.
4-1-76	Filed pliffs supplemental pre trial memo of law.
4-12-76	Filed Affidavit & Notice of Motion by depts Eastman Dillon & Co. & M. Scott, for an order requiring pliff to serve a response to the document request annexed as Exhibit A, etc, rtble before Pierce, J. on 4-16-76.
4-12-76	Filed depts memorandum in support of said motion.
4-12-76	Filed depts request that pliff produce documents, etc, as indicated.
4-14-76	Filed pliffs objections to depts Blyth, Eastman Dillon & Co., etc, and Michael Stotts request for production of documents.
4-19-76	Filed Affidavit & Notice of Motion by depts Blyth, Eastman Dillon & Co. Inc. and M. Scott for an order requiring pliff to produce at trial the documents described etc, rtble before Pierce, J. on 4-23-76.
4-19-76	Filed memorandum in support of motion by depts indicated.
4-20-76	Filed memo endorsed on motion filed 4-12-76. Motion withdrawn with leave of Court.
4-23-76	Filed pliffs memorandum of law in opposition to the motion of depts Blyth, Eastman Dillon & Co. Incorp. and M. Scott to compel discovery.
4-23-76	Filed Affidavit of depts Blyth Eastman Dillon & Co. and M. Scott in reply to the memorandum submitted by pliff, etc, as indicated.
4-29-76	Filed memo endorsed on motion filed 4-19-76. Depts motion pursuant to Rule 37 and the request for production of documents pursuant to Rule 34 are denied as untimely. No costs will be awarded. Motion denied. Pierce, J. M/N.
6-23-76	Filed Notice that pliff will take deposition of depts A. Yamada on 6-23-76.
6-23-76	Filed order that the above matter is referred to Mag. Schreiber etc, as indicated, Pierce, J.
6-23-76	Extry trial begun without a jury
6-24-76	Trial cont'd
6-25-76	Trial cont'd & adjourned to 7-6-76
7-6-76	Trial trial cont'd
7-7-76	Trial cont'd
7-8-76	Trial cont'd
7-12-76	Trial cont'd
7-13-76	Trial concluded-Dec. Res.
7-20-76	Filed pliffs Affidavit in support of pliffs motion for an order compelling discovery etc, as indicated.
7-20-76	Filed Affidavit of Harry A. Lessler atty for depts Yamada dtd. 5-22-76.
8-3-76	Filed stip & order between pliff and atty for depts Akiyoshi Yamada the the same is discontinued as against depts Akiyoshi Yamada, without prejudice and without costs. Pierce, J.
9-1-76	Filed Pliffs Post Trial memorandum of law as indicated.
9-1-76	Filed Pliffs proposed findings of fact as indicated.
9-1-76	Filed Pliffs proposed conclusions of law as indicated.
9-15-76	Filed Pliffs Affidavit & Notice of Motion for an order reopening the trial of this action for the purpose of admitting into evidence certain material, etc, rtble on 9-23-76.
9-15-76	Filed pliffs memorandum of law in support of motion for leave to reopen trial.
9-20-76	Filed Post Trial Brief of depts Blyth Eastman Dillon & Co Incorp. and Michael Scott.
9-20-76	Filed proposed findings of fact and conclusions of law submitted by depts Blyth, Eastman Dillon & Co. Incorp. and Michael Stott.
9-23-76	Filed memorandum by depts Blyth Eastman Dillon & Co. and Michael Stott in opposition to motion to reopen record.
10-5-76	Filed Post Trial Brief of depts Akiyoshi Yamada as indicated.
10-12-76	Filed Transcript of record of proceedings, dtd. 7-12-76, 1976.

OVER

PROCEEDINGS

DATE

10-12-76 Filed Transcript of record of proceedings, dtd. 6-23-25-27-1976.
 10-12-76 Filed Transcript of record of proceedings, dtd. July 8, 7, 8, 1976.
 10-13-76 Filed pliffs reply memorandum of law in support of motion to reOpen record.
 10-13-76 Filed pliffs post-trial reply- memorandum of law.
 2-17-76 Filed transcript of record of proceedings, dated 6-21-76.
 1-18-77 Filed post-trial brief of dfts. Blvth, Eastman Dillon & Co., Inc. and Michael Stott.
 1-18-77 Filed Opinion #45531. Judgment for plfff. in the amt. of \$55,790.00 plus interest as indicated. Judgment should be entered dismissing pliffs. claims against dft; Akiyoshi Yamada & dismissing cross claims of dfts. Bedco & Stott against Yamada. Pliffs. counsel directed to submit order of judgment on 3 days notice.....Pierce J. (m)
 2-2-77 Filed Order & Final Judgment #77,243 It is adjudged ad decreed, that plfff. recover from defts. BEDCO and Stott the sum of \$55,790 and that the cross-claims asserted by Bedco and Stott against Yamada be dismissed with prejudice, and that the complaint be dismissed without prejudice and without costs as against debt Yamada, and that the costs of the action be taxed against defts. Bedco and Stott.....PIERCE/J. Judgment Ent. 2/3/77. m/n
 2-22-77 Filed Pliffs. Notice of appeal to 2 nd Circuit from the first decretal paragraph of the Order and Judgment, entered on Feb. 3, 1977. Mailed copy.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JA 5

DAVID E. ROLF,

Plaintiff,

-against-

BLYTH, EASTMAN DILLON & CO.,
INCORPORATED, AKIYOSHI YAMADA and
MICHAEL STOTT,

Defendants.

Judge Pierce
73 Civ. 2967

COMPLAINT

Plaintiff, by his attorneys, Silverman & Harnes, alleges upon information and belief, except for paragraph "2", which is based upon personal knowledge:

1. The jurisdiction of this Court is based upon the Securities Act of 1933 ("Securities Act"), Sections 1 through 26, as amended (15 U.S.C. Section 77(a), et seq.) and, in particular, Section 17(a) (15 U.S.C. Section 77(g)), the Securities Exchange Act of 1934 ("Exchange Act") Sections 1 through 34, as amended (15 U.S.C. Sections 78(a), et seq.), and, in particular, Section 10(b) (15 U.S.C. Section 78j(b)) and Rule 10b-5 promulgated thereunder (17 C.F.R. 240.10b-5), Section 15(c)(1) (15 U.S.C. Section 78c(1)) and Rule 15c1-2 promulgated thereunder (17 C.F.R. 240.15c1-2) and Sections 15A and 27 (15 U.S.C. Sections 78A and 78aa), Rule 405(1) and (2) promulgated by the New York Stock Exchange pursuant to the provisions of the Exchange Act, and Article II, Section 2 of the rules of Fair Practice adopted by the National Association of Securities Dealers, Inc. promulgated pursuant to the provisions of the Exchange Act.

2. Plaintiff is a physician specializing in the field of ophthalmology. He resides at 16210 Parkland Drive, Shaker Heights, Ohio, and practices medicine at the Cleveland Eye Clinic,

2740 Carnegie Avenue, Cleveland, Ohio. Plaintiff devotes his full time and attention to the practice of medicine and has, for many years, relied upon and used the services of stock brokers and investment advisers to manage and supervise his personal investments.

3. Defendant Blyth, Eastman Dillon & Co. Incorporated ("Blyth, Eastman Dillon") (successor corporation to Eastman Dillon, Union Securities & Co., Incorporated) is a registered broker dealer and a member of the New York Stock Exchange and the National Association of Securities Dealers, Inc. (NASD). It maintains its principal executive offices at One Chase Manhattan Plaza, New York, New York.

4. Defendant Michael Stott ("Stott") is a registered representative and has been employed as such by defendant Blyth, Eastman Dillon during all relevant times.

5. (a) Defendant Akiyoshi Yamada ("Yamada") resides at 941 Park Avenue, New York, New York. From May 1, 1969 through June 30, 1971, he acted as plaintiff's investment adviser with full discretion to buy and sell securities for plaintiff's account.

(b) In 1972, defendant Yamada was enjoined by the Securities and Exchange Commission ("SEC") from engaging in fraudulent and manipulative activities in connection with the purchase and sale of securities and indicted by a grand jury convened in this district as a result of such illegal activities.

6. Plaintiff has been a client of defendant Blyth, Eastman Dillon for many years. Pursuant to an agreement between

plaintiff and defendant Blyth, Eastman Dillon, defendant Blyth, Eastman Dillon had full and complete discretion to invest and re-invest plaintiff's account. Plaintiff's account was managed by S. Logan Stirling ("Stirling") a partner of defendant Blyth, Eastman Dillon. That arrangement continued until May, 1969.

7. In early 1969 Stirling became incapacitated because of illness. Defendant Blyth, Eastman Dillon did not promptly convey that information to plaintiff. Several months later, plaintiff was informed by a representative of defendant Blyth, Eastman Dillon that his account had been turned over to defendant Stott, who was not a partner. Plaintiff expressed concern that his account had not been turned over to a partner and stated to defendant Blyth, Eastman Dillon that he did not believe defendant Stott had sufficient experience to manage his account.

8. In order to overcome plaintiff's objection and retain his account, defendant Stott introduced plaintiff to defendant Yamada representing that defendant Yamada was a highly skilled, thoroughly trained and reputable investment adviser and would assist defendant Stott in managing plaintiff's account. On May 1, 1969, plaintiff agreed to the arrangement proposed by defendant Stott.

9. On April 30, 1969, plaintiff's investments consisted of blue chip securities. His equity in such securities was \$1,092,541.

10. (a) During the period May 1, 1969 through March 28, 1971, when defendants managed plaintiff's account they engaged in an excessive number of trades and severely altered the quality of his portfolio by purchasing low grade and highly

speculative securities. As a result of the aforementioned activity, plaintiff sustained substantial realized and unrealized losses.

(b) During the period of time plaintiff's account was managed by defendants, defendant Blythe, Eastman Dillon obtained brokerage commissions of \$42,341.80 (plus margin interest of \$13,448.20). Defendant Yamada during this same period had the use of plaintiff's capital to engage in manipulative activities.

(c) Plaintiff, on many occasions, complained to Defendant Stott that securities purchased for his account were of low quality and that there appeared to be excessive trading activity in such account. Defendant Stott each time advised plaintiff that the account was being properly managed as an investment account.

11. From May 1, 1969 through June 30, 1971, defendants Yamada and Stott, aided and abetted by defendant Blyth, Eastman Dillon, jointly and in concert, contrary to the best interests of plaintiff and for their own gain, intentionally and wilfully induced purchases and sales of stock in plaintiff's account which were excessive in size and frequency in the light of the character of such account. Defendants Yamada and Stott, aided and abetted by defendant Blyth, Eastman Dillon, engaged in churning activities, including the following practices: "in and out trading", "reversals", "cross trading", "shuffling" and "switching".

12. Defendant Blyth, Eastman Dillon had a duty to exercise due diligence and to supervise plaintiff's account. Defendant Blyth, Eastman Dillon wilfully, intentionally and in callous and reckless disregard of its fiduciary duty to its customers, and in violation of the rules of the New York Stock

Exchange and the NASD failed to supervise plaintiff's account and the transactions therein. Defendant Blyth, Eastman Dillon should have been aware of the excessive trading because such trading far exceeded the average trading of similar accounts. Moreover, the overall pattern of plaintiff's account indicated selling after a relatively short period of retention.

13. Defendant Blyth, Eastman Dillon knew or should have known that fraudulent activity was taking place with respect to plaintiff's account because of the excessive amount of trading, the change in quality of the securities included in the account, and the excessive amounts of commissions generated. Defendant Blyth, Eastman Dillon failed to institute appropriate supervisory procedures and internal controls to apprise itself of the fraudulent activities of defendants Yamada and Stott or otherwise to exercise the proper supervision with respect to its customer's account. Defendant Blyth, Eastman Dillon thereby participated in the fraud perpetrated by its employee defendant Stott acting in concert with defendant Yamada, all to plaintiff's detriment.

WHEREFORE, plaintiff prays for damages to compensate him for his losses, including:

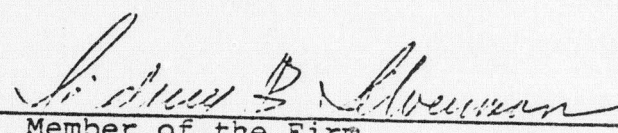
1. The commissions and interest collected;
2. The loss in value in the original portfolio computed either as (a) the difference between the market value of the securities contained in the original portfolio and the actual value of the account after churning took place or (b) the loss in value of the original portfolio based upon what it would have amounted to had it been properly managed;
3. An accounting for the profits made by defendants;

4. An award of costs, including attorneys' fees and accountants' fees;
5. Punitive damages of \$1,000,000; and
6. Such other just and equitable relief as the Court in its discretion may deem appropriate.

Dated: New York, N.Y.
 , 1973

SILVERMAN & HARNES

By


Member of the Firm

Attorneys for Plaintiff
One Rockefeller Plaza
New York, New York 10020

Tel: 765-7884

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JA 11

----- x
DAVID E. ROLF,

Plaintiff,

-against-

BLYTH EASTMAN DILLON & CO.
INCORPORATED, AKIYOSHI YAMADA
and MICHAEL STOTT,

Defendants.
----- x

: 73 Civ. 2967
: (LP)

: ANSWER AND
: CROSS-CLAIM

Defendants Blyth Eastman Dillon & Co. Incorporated
("Blyth") and Michael Stott ("Stott"), by their attorneys,
Breed, Abbott & Morgan, for their answer to the complaint
herein:

1. Deny each and every allegation contained in
paragraphs 1, 10(a), 10(c), 11, and 13.

2. Deny knowledge or information sufficient to form
a belief with respect to the allegations contained in para-
graph 2, except admit on information and belief that plaintiff
is a physician specializing in the field of ophthalmology,
resides at 16210 Parkland Drive, Shaker Heights, Ohio, and
practices medicine at the Cleveland Eye Clinic, 2740 Carnegie
Avenue, Cleveland, Ohio.

3. Deny each and every allegation contained in para-
graph 3, except admit that Blyth is a registered broker dealer
and a member of the New York Stock Exchange and the NASD, with
principal offices at One Chase Manhattan Plaza, New York, New
York.

4. Deny each and every allegation contained in paragraph 4, except admit that Stott is presently employed by Blyth as a registered representative and prior to that by Eastman Dillon, Union Securities & Co., Inc. and Eastman Dillon, Union Securities & Co.

5. Deny knowledge or information sufficient to form a belief with respect to the allegations contained in paragraph 5, except that reference is made to a trading authorization executed by plaintiff on or about May 9, 1969, a copy of which is annexed hereto as Exhibit A. Reference is made to said document with respect to the content thereof.

6. Deny each and every allegation contained in paragraph 6, except admit that plaintiff maintained an account with Eastman Dillon, Union Securities & Co. from in or about 1963 and thereafter with Eastman Dillon, Union Securities & Co., Inc. and except that reference is made to a trading authorization executed by plaintiff on or about October 20, 1963, a copy of which is annexed hereto as Exhibit B. Reference is made to said document with respect to the content thereof.

7. Deny knowledge or information sufficient to form a belief with respect to the allegations contained in paragraph 7, except deny that information concerning Stirling was not promptly conveyed to plaintiff.

8. Deny each and every allegation contained in paragraph 8, except that reference is made to Exhibit A hereto with respect to the content thereof.

9. Deny knowledge or information sufficient to form

a belief with respect to the allegations contained in paragraph 9, except that reference is made to plaintiff's account statements during the period referred to, which statements are available for inspection and copying.

10. Deny each and every allegation contained in paragraph 10(b), except that reference is made to plaintiff's account statements during the period referred to, which statements are available for inspection and copying.

11. Deny each and every allegation contained in paragraph 12, except admit that such duties were owed to plaintiff as were imposed and existed under applicable law.

FIRST DEFENSE

12. The complaint fails to state a claim against either Blyth or Stott upon which relief can be granted under any of the provisions pursuant to which the action is sought to be maintained.

SECOND DEFENSE

13. The claims asserted in the complaint are barred by laches and by the applicable statute of limitations.

THIRD DEFENSE

14. The claims asserted in the complaint are barred by applicable principles of estoppel and waiver.

CROSS-CLAIM

15. If plaintiff recovers judgment against Blyth or Stott by reason of any of the acts, transactions or omissions

alleged in the complaint, such judgment will have been brought about and caused wholly or primarily by the acts, commissions or omissions of defendant Akiyoshi Yamada ("Yamada"), and Blyth and Stott therefore are or may be entitled to indemnification or contribution from Yamada for all or part of any such judgment.

WHEREFORE, defendants Blyth Eastman Dillon & Co. Incorporated and Michael Stott demand judgment: (a) dismissing the complaint herein together with the costs and disbursements of this action and reasonable attorney's fees; (b) in the event that a judgment is rendered herein against either Blyth or Stott, awarding them judgment against Yamada for the full amount recovered, together with costs and disbursements of this action; and (c) granting such other and further relief as to this Court seems just and proper.

BREED, ABBOTT & MORGAN

By Thomas W. Kelly
A Member of the Firm
Attorneys for Defendants Blyth
Eastman Dillon & Co. Incorporated and Michael Stott
1 Chase Manhattan Plaza
New York, N.Y. 10005
944-4800

JA 15

MESSRS. EASTMAN DILLON, UNION SECURITIES & Co.
One Chase Manhattan Plaza
New York 5, N. Y.

Gentlemen:

I hereby authorize AKI YAMADA to buy, sell, including short sales, and trade in, for my account and risk and in my name, stocks, bonds and any other securities and/or commodities on margin or otherwise and in accordance with your terms and conditions; and I hereby agree to indemnify and hold you harmless from and to promptly pay you on demand any and all losses arising therefrom or debit-balance due thereon. You will kindly follow his instructions in every respect concerning my account with you, and make payments of moneys and deliveries of securities to him or otherwise as he may order and direct. In all matters and things aforementioned he is authorized to act for me and in my behalf in the same manner and with the same force and effect as I might or could do.

I hereby waive notification to me of any of the aforementioned transactions and delivery of any statement or notices or demands pertaining thereto and hereby ratify any and all transactions heretofore or hereafter made by him on or for my account.

This authorization is a continuing one and shall remain in full force and effect until receipt from me of written notice of my revocation thereof.

Dated 5/9/69

Cleveland
City

Ohio
State

Very Truly yours,

David E. Rolf
David E. Rolf, M.D.

Accepted

Aki Yamada
Signature of Authorized Agent
Aki Yamada

TRADING AUTHORIZATION LIMITED TO PURCHASES AND
SALES OF SECURITIES AND COMMODITIES

EASTMAN DILLON, UNION SECURITIES & Co.
15 Broad Street
New York 5, N. Y.

JA 16

Gentlemen:

The undersigned hereby authorizes S. L. Stirling (whose signature appears below) as his agent and attorney in fact to buy, sell (including short sales) and trade in stocks, bonds and other securities and/or commodities and/or contracts relating to the same on margin or otherwise in accordance with your terms and conditions for the undersigned's account and risk and in the undersigned's name, or number on your books. The undersigned hereby agrees to indemnify and hold you harmless from and to pay you promptly on demand any and all losses arising therefrom or debit balance due thereon.

In all such purchases, sales or trades, you are authorized to follow the instructions of Mr. S. L. Stirling in every respect concerning the undersigned's account with you; and he is authorized to act for the undersigned and in the undersigned's behalf in the same manner and with the same force and effect as the undersigned might or could do with respect to such purchases, sales or trades as well as with respect to all other things necessary or incidental to the furtherance or conduct of such purchases, sales or trades.

The undersigned hereby ratifies and confirms any and all transactions with you heretofore or hereafter made by the aforesaid agent or for the undersigned's account.

This authorization and indemnity is in addition to (and in no way limits or restricts) any rights which you may have under any other agreement or agreements between the undersigned and your firm.

This authorization and indemnity is also a continuing one and shall remain in full force and effect until revoked by the undersigned by a written notice addressed to you and delivered to your office at _____, but such revocation shall not affect any liability in any way resulting from transactions initiated prior to such revocation. This authorization and indemnity shall enure to the benefit of your present firm and of any successor firm or firms irrespective of any change or changes at any time in the personnel thereof for any cause whatsoever, and of the assigns of your present firm or any successor firm.

Dated, 9/20/63

Cleveland Ohio
(City) (State)

Very truly yours,

Grace Matsushime
Witness

SIGNATURE OF AUTHORIZED AGENT:

FEB 24 7-57

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
DAVID E. ROLF,

Plaintiff,

- v -

BLYTH EASTMAN DILLON & CO., INC.,
AKIYOSHI YAMADA, and MICHAEL
STOTT,

Defendants.
-----X

73 Civ. 296.

APPEARANCES:

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New York, New York 10019

Attorneys for Plaintiff

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New York, New York 10005

Attorneys for Defendants Blyth Eastman
Dillon Co. and Michael Stott

BARRY A. TESSLER, ESQ.
110 East 59th Street
New York, New York 10022

Attorney for Defendant Akiyoshi Yamada

LAWRENCE W. PIERCE, D.J.

OPINION AND ORDER

This securities action brought by plaintiff David E. Rolf presents important questions concerning the duties and

responsibilities of a broker dealer and its registered representative under circumstances in which their customer is being defrauded by his investment adviser. Unlike the usual case brought under the federal securities laws, here it is clear that fraud and breach of fiduciary duty are present. The key questions in this case are whether the broker aided or participated in the fraud, and whether the broker and his employer took adequate steps to protect their customer against the investment advisor who traded plaintiff's account pursuant to a power of attorney.

The matter was tried before the Court without a jury for nine days in June and July 1976. The allegations of the complaint are as follows.

Plaintiff David Rolf's complaint seeks to hold defendants liable in damages for alleged violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, which prohibits securities fraud by any person through the instrumentalities of interstate commerce or of any facility of any national securities exchange. Also claimed are violations of Section 15(c)(1) of the Exchange Act, and Rule 15c1-2, which similarly prohibit securities fraud by broker dealers in the over-the-counter markets. Plaintiff also alleges violations of Section 15A of the Exchange Act, dealing with registration and regulation of broker dealer associations, and of Article III, Section 2 of the Rules of Fair Practice adopted by the National Association of Securities Dealers, Inc. ("NASD") promulgated

thereunder, the latter requiring suitability of securities recommended by brokers for investors. Finally, plaintiff asserts violations of Rule 405(1) and (2) of the New York Stock Exchange ("NYSE"), which require due diligence and diligent supervision in the management of securities accounts handled by registered representatives.

This Court has jurisdiction over this action brought to enforce liabilities and duties created under the Exchange Act and by the rules and regulations promulgated thereunder pursuant to 15 U.S.C. §78aa.

In brief, plaintiff claims that the defendants churned his account, that they severely altered the nature of his securities portfolio by placing unsuitable securities therein, that they failed to properly supervise his account, and that they aided and abetted each other in these alleged violations. In sum, plaintiff claims that the defendants took an account worth \$1,423,000 in May of 1969 and returned to him in January of 1971 an account worth only \$225,000 as a result of their fraud. For damages, plaintiff seeks, inter alia, a return of commissions and interest; an award equal to the net trading losses claimed; and, although the complaint states no cause of action under state law, punitive damages of one million dollars.

At the trial of this action, plaintiff abandoned all claims made against his investment adviser, defendant Akiyoshi Yamada, in exchange for Yamada's testimony against the remaining defendants (see PX-19). Defendants Blyth Eastman Dillon & Co.

("BEDCO") and its registered representative Michael Stott assert that they are not liable because plaintiff has not proved his claims, because Yamada and not the other defendants controlled plaintiff's account, and because they breached no duty owed to the plaintiff. In their answer defendants BEDCO and Stott assert cross-claims against Yamada for indemnity.

Having heard all the evidence and having considered the matter, the Court dismisses plaintiff's churning claim, but finds defendants BEDCO and Stott liable for violations of the NYSE and NASD rules, which violations involved breach of defendants' fiduciary duties tantamount to fraud. The Court also finds defendant Stott liable for aiding and abetting Yamada in the fraud which the investment adviser perpetrated upon plaintiff in violation of Rule 10b-5 and through breach of his own fiduciary duties. The following shall constitute the Court's findings of fact and conclusions of law pursuant to Rule 52(a) Fed.R.Civ.P.

The Parties

Plaintiff David E. Rolf is a physician, surgeon and ophthalmologist residing in Shaker Heights, Ohio. Dr. Rolf has practiced medicine since 1936, and at the time of trial he was sixty-eight years old. Rolf began investing his earnings in the stock market in 1950, and by 1962 his portfolio was worth approximately \$400,000. Plaintiff testified that he works long hours at the hospital, and that he is on twenty-four hour call. During the period 1950 through 1962, plaintiff retained several

different Cleveland brokers, switching firms often because he felt that the brokers were not sufficiently knowledgeable and that they did not have his interests at heart. During this period plaintiff maintained non-discretionary accounts, making his own decisions with respect to transactions in securities. Rolf was an active follower of the stock market, primarily through the Wall Street Journal. Prior to his first contact with BEDCO in 1963, plaintiff had maintained accounts at Merrill Lynch, Pierce, Fenner & Smith, Inc., Paine Webber & Co., Hartzmark & Co., Prescott & Co., Bache & Co., and finally, at Walston & Co. where Rolf first engaged an investment adviser with discretionary authority over his securities. Rolf stated that during this period his investment objective was capital growth first and security second. Plaintiff testified that he switched to discretionary accounts in 1962 because he was too busy with medicine to be in constant consultation with brokers, and because he felt his portfolio was too large for him to handle.

In 1963, plaintiff took his securities to Eastman Dillon Union Securities & Co., and entrusted their management to S. Logan Stirling, a partner and a prominent investment adviser associated with that firm and with defendant BEDCO, the successor corporation to Eastman Dillon Union Securities & Co. BEDCO was at all relevant times a registered broker dealer and a member of the New York Stock Exchange and the

National Association of Securities Dealers. During the relevant period, BEDCO engaged in corporate and municipal underwritings, maintained a large research department, and employed a substantial retail sales force. BEDCO dealt in listed and over-the-counter securities for individual clients and as a market-maker (Tr. 1005).

While Dr. Rolf did not come into contact with BEDCO's Michael Stott until 1969, Stott had been a registered representative with that firm since 1958, and in 1963 Stott was branch manager of BEDCO's Paterson, New Jersey, office. Later Stott became branch manager of BEDCO's Newark office; at each branch office one of his primary responsibilities was supervision of the registered representatives (Tr. 757). In the fall of 1967 Stott returned to BEDCO's New York office as a registered representative. By 1969, Stott was handling approximately 150 individual and institutional accounts at BEDCO, earning one-third of all commissions on the securities he traded (Tr. 914-15). That year Stott first met a young and ambitious investment adviser, Akiyoshi Yamada.

Yamada, the son of a wealthy Japanese industrialist, had attended Harvard Business School for one year prior to 1965 when he joined the investment banking firm of Kuhn Loeb & Co. (Tr. 557). Yamada described Kuhn Loeb as a conservative and prestigious firm which generally handled "triple-A" clients. (Tr. 509). At Kuhn Loeb, Yamada eventually became an officer of the firm purportedly with expertise in research and "special

situations". In 1969, at the age of 26, Yamada left Kuhn Loeb to form an investment partnership; during the period of the complaint he was not associated with any research firm or brokerage house (Tr. 558).

Yamada was described at trial by John P. Cione, BEDCO's chief compliance officer, as one of a "new breed" of young money-managers who emerged as highly successful in the stock market during 1969 and 1970. Yamada was committed to "special situations" and was one of a number of young advisers who were making mutual funds, hedge funds, and assorted speculative ventures very profitable (Tr. 1111). During the period of the complaint Yamada was handling six sizeable portfolios, three institutional and three individual, of which Dr. Rolf's was the largest individual account. Yamada traded plaintiff's stocks on a discretionary basis from April 1969 through January 1971 (Tr. 1041-42).

In 1972, defendant Yamada was enjoined by the Securities and Exchange Commission from engaging in fraudulent and manipulative practices in connection with the purchase and sale of securities. On December 21, 1972, at the age of thirty, Yamada pleaded guilty before Judge Irving Ben Cooper of this Court to a criminal conspiracy to violate the federal securities laws as set forth in Count One of Indictment 72 Cr. 363, in connection with the sale of Lady Goldie Bracelet Co. securities. On May 18, 1973, Yamada pleaded guilty to two further violations of 18 U.S.C. §371 set forth in criminal informations 73 Cr. 426 and 73 Cr. 427,

in connection with a securities fraud involving Microthermal Applications, Inc., and a manipulation of Health Evaluation Systems, Inc., the stock of the latter being one involved in this action. On June 26, 1973, Judge Cooper sentenced Yamada to two years in prison, five years on probation, and fined him \$30,000. Thereafter, on April 15, 1974, Yamada pleaded guilty to submitting false statements to Judge Cooper in support of a motion to reduce or suspend his sentence, in violation of 18 U.S.C. §1001. For this crime, Judge Morris Lasker of this Court sentenced Yamada to one year, later reduced to six months, consecutive to the previously imposed period of imprisonment. (See DX-VV,. Yamada admitted each of these convictions at trial, and further admitted that he had perjured himself before the Securities and Exchange Commission (Tr. 695).

The foregoing discussion raises questions regarding Yamada's credibility as a witness in this action. However, the Court finds that on many points Yamada's testimony is supported by that of Rolf or by documentary evidence. Further, the Court finds that it cannot credit the whole of the testimony of either of the other two principal witnesses, Dr. Rolf and Michael Stott.

Plaintiff's Investment Intent

Dr. Rolf's claim that he was an unsophisticated investor is undercut both by the events leading up to and those during the period of the complaint. First, as noted, plaintiff in earlier years had engaged a series of brokerage

firms on a non-discretionary basis. Further, plaintiff makes no complaint concerning the securities bought for his account by S. Logan Stirling of BEDCO from 1963 through March 1969, and there is substantial evidence that certain of those stocks were aggressive investments.

The best evidence of Rolf's investment intent during the Stirling period is contained in a letter from the plaintiff to Stirling dated June 14, 1967:

"My objective is to double my equity.
It will be interesting to see how
long it takes." (DX-C)

Plaintiff testified that during the Stirling period, he would have been happy with an annual growth rate of ten percent, but that he would have been dissatisfied with anything less (Tr. 315).

There is substantial evidence that Dr. Rolf kept careful watch over his securities. During the period of the complaint, plaintiff checked the published prices of his securities three or four times per week (DX-III). He also employed a bookkeeper to keep track of his holdings and their value, both during the Stirling period and during the period of the complaint (Tr. 307; PX-24).

Further, although Rolf gave Stirling complete discretionary authority over his account (DX-P), the doctor telephoned Stirling's office as many as six times per week (Tr. 741). Rolf testified that he was fully satisfied with Stirling's handling of his BEDCO account, and pleased by the fact that

the size of the portfolio more than doubled in the six years between 1963 and 1969.

In mid-March 1969, S. Logan Stirling took ill and left BEDCO, having suffered a brain tumor which proved fatal. Plaintiff claims, but the evidence does not support the conclusion, that Stirling was incapacitated as early as late 1968. However, the Court does conclude that from March through early May 1969, Rolf's million-dollar account went unattended by anyone at BEDCO. BEDCO's compliance officer admitted not only that the account was "dormant" during the period between Stirling's illness and Rolf's selection of Yamada, but further that during April 1969 some unidentified person at BEDCO sold one thousand shares of Talcott National Corp., purchased one thousand shares of Asamera Oil Corp., and sold one thousand shares of Occidental Petroleum Corp. (Tr. 1069-71; see DX-UU). This apparent indifference to plaintiff's investment needs at BEDCO is further illustrated by the manner in which Akiyoshi Yamada came to be selected as Rolf's investment adviser.

Michael Stott testified that following Stirling's departure from BEDCO, Mr. Schlesinger, a BEDCO partner, assigned the Rolf account to him. In late April 1969, Stott telephoned Rolf and offered to handle his account. Rolf stated that he wanted an investment adviser, and that Stott, while a capable and experienced broker, was just not an analyst with sufficient expertise to direct his investments. However, Rolf was willing to keep the account at BEDCO, and he asked Stott to recommend an investment adviser.

Stott testified flatly that he never knew what Rolf's investment objectives were (Tr. 881-82), and further, that he did not even look at the stocks in plaintiff's portfolio prior to their first contact (Tr. 941-48). Accordingly, the Court concludes that Stott recommended two advisers, Akiyoshi Yamada and Donald Geddes, knowing nothing about the plaintiff beyond the fact that Rolf's account had been handled by Mr. Stirling.

While Stott's trial testimony on the point is somewhat inconsistent with his deposition (see Tr. 888-89), it appears that Stott did little more than give plaintiff two names and two telephone numbers.

Dr. Rolf testified that Stott told him Geddes had experience with large accounts; however, according to the plaintiff, Yamada was more fully described. Stott told Rolf that Yamada had a Harvard Business School background, that he was from an illustrious and wealthy Japanese family, and that he was a brilliant analyst. Rolf travelled to New York shortly thereafter to interview the two.

Rolf and Yamada met in a New York restaurant to discuss plaintiff's investments. Rolf thought Yamada both brilliant and capable, but was somewhat wary of Yamada's youth (Tr. 31). When Rolf spoke of an interest in preserving his equity, Yamada assured him that none of his clients had ever lost a penny (Tr. 30).

Yamada's testimony concerning Rolf's objectives is consistent with the rest of the evidence in the case. While Yamada stated that Rolf was unsophisticated and "groping" for guidance, it was clear to Yamada that Rolf wanted a very aggressive investment program, and that he was willing to engage in extensive trading in order to "double his equity" (Tr. 511, 514; PX-3).

Yamada's testimony to the effect that Rolf was interested in special situations, new issues, and aggressive trading is confirmed by a letter written by Rolf to Yamada much later. In that letter dated September 2, 1970, Rolf referred to his original investment intent as follows:

"As you recall, we started out with roughly \$2,000,000. of Securities which could be used for trading. . . . It was my impression that we would wind up with 3.5 to 5 million in a years time." (PX-3)

In brief, Dr. Rolf decided that Yamada would be an appropriate investment adviser, and although he also interviewed Geddes, plaintiff settled on Yamada.

Rolf and Yamada agreed that Yamada would receive compensation equal to ten percent of plaintiff's capital gains. Rolf requested that trading be done through BEDCO and Stott, if at all possible. Rolf testified repeatedly, and the Court credits the statements, that Rolf sought to balance Yamada's youth and zeal with BEDCO and Stott's reliability and supervision. Indeed, in the plaintiff's mind, by the combination of Stott and

Yamada, he was obtaining a "Stirling-type" operation (Tr. 35). Rolf told Stott that he expected BEDCO to look after his account, and that he didn't intend to keep his commission business at BEDCO without receiving something in return (Tr. 34). On May 9, 1969, Rolf executed a trading authorization granting to Yamada full discretionary authority over his BEDCO account:

"Messrs. Eastman Dillon,
Union Securities & Co.

"Gentlemen:

"I hereby authorize AKI YAMADA to buy, sell, including short sales, and trade in, for my account and risk and in my name, stocks, bonds and any other securities You will kindly follow his instructions in every respect concerning my account with you . . . as he may order and direct. In all matters and in all things aforementioned he is authorized to act for me and in my behalf in the same manner and with the same force and effect as I might or could do" (DX-B)

The Stocks

It is clear from the evidence that in May 1969, Rolf expected Yamada to take substantial risks for capital gains, but at the same time to preserve the million dollar portfolio which Rolf had built up over the years through his own earnings and efforts and through the efforts of prior brokers. Indeed, since Rolf had no pension or retirement plan, his stocks represented his main security for his later years (Tr. 19).

It is also clear that Rolf expected BEDCO to supervise his account and Rolf understood that Stott was to look after his interests. As Rolf testified, he made this clear to Stott at the outset:

"I said, 'Mike, I can take this account any place. I am going to leave this account here,' but I said, 'Look, I want you to watch this. After all, you are going to be compensated for this, you are going to get all the commission business, and when I am back in Cleveland and busy, you keep your eye on things.'" (Tr. 34)

Contrary to his expectations, Rolf received from Yamada only the substantial risks and he received no supervision by BEDCO. The explanation lies in how Stott and Yamada saw their respective roles and in the very effective methods they used to shuffle Rolf between the two of them.

On May 9, 1969, the date when Rolf gave Yamada the trading authorization, Rolf's margin account contained twenty-three issues, all but one of which had been purchased by Stirling:

- Loew's Theatres Wts.
- Leasco Data Processing Wts.
- Anaconda Co.
- Asamera Oil Corp.
- Avnet Inc.
- Buttes Gas & Oil Co.
- CNA Financial Corp.
- Cities Service Co.
- Ebasco Industries Inc.
- Glen Alden Corp.
- INA Corp.
- International Industries Inc.
- General Electric Co.
- Leesona Corp.
- Levin Townsend Computer Corp.
- Loew's Theatres Inc.
- National General Corp.
- Occidental Petroleum Corp.
- Penn Central Co.
- Pittson Co.
- Raytheon Corp.
- Scientific Resources Corp.
- Teledyne Inc.

(DX-UU at 2)

With the exception of the two warrants, each of the above securities were listed on the American or the New York Stock Exchange. Eighteen were issued by companies that had enjoyed continuous profits for five years or longer. Sixteen paid cash dividends. Yamada characterized six of the issues as "blue chip" and plaintiff's expert witness made similar observations. Yamada described the warrants as "aggressive" investments and two of the stocks as "racy". As of May 9, 1969, after reducing the value of the portfolio by the debit balance, plaintiff's margin account was worth \$1,423,000 net.

Both Yamada and Rolf testified that they agreed in April 1969 to make certain changes in the account. Yamada was of the opinion that many of the stocks involved had seen their day, and that it was time to move on to newer and more profitable investments. However, Yamada stated that Rolf did not agree to liquidate the account; that decision was made by the adviser alone. Between May 1969 and January 1970, Yamada sold all 23 issues, 14 at a loss. Plaintiff made no complaint.

The evidence in this case most fraught with hazards concerning credibility is the testimony of Stott and Yamada regarding their relations with each other. However, it is clear that the two were in contact by telephone several times daily.^{1/} Further, Stott continually conveyed to Yamada the

^{1/} Stott testified in his deposition that he spoke to Yamada only twenty or thirty times during the entire one and one-half year period. However, at trial Stott admitted that he was in daily contact with Yamada (Tr. 775, 817).

recommendations of BEDCO's research department with respect to certain issues, and many of those stocks were subsequently purchased for Rolf's account.

While Yamada and Stott met socially only on occasion, it is clear that their business interests were intertwined. Yamada stated that he relied upon Stott for recommendations with respect to oil and gas stocks; Stott's testimony on this point is equivocal.^{2/} There is no dispute that Stott had family connections with the management of two oil companies whose issues were purchased for Rolf, Standard Oil of New Jersey and West Coast Production.

Stott testified that he handled a total of six accounts referred to him by Yamada, but he stated that these accounts produced only a small proportion of his commission income (Tr. 794-95). Of the forty-one issues purchased for Rolf by Yamada and Stott during the complaint period, thirty-five were at some point traded through BEDCO (PX-24). Yamada testified that Stott recommended a total of twelve of the issues involved (Tr. 518-530); Stott admitted to recommending six of these.

With respect to the stocks which he did admit he recommended to Yamada, Stott testified that he did not specifically recommend the stocks for Rolf. Rather, Stott maintained that he simply gave Yamada the results of BEDCO's research, and that the recommendations were in actuality for Yamada's more speculative

^{2/} When asked if oil stocks were one of his specialties, Stott answered "not really" (Tr. 965). Stott did admit that Yamada bought Rolf oil stocks "partially" on his advice (Tr. 965).

ventures, such as Takara Partners and the hedge funds (Tr. 780-81). The Court does not find this attempted distinction credible, particularly in light of the fact that Stott himself continually executed purchases and sales in these very stocks for Rolf's account; in these circumstances, there can be little doubt that Stott realized that Yamada was, at least in part, relying on the recommendations made by Stott and by BEDCO research in determining what to buy for the plaintiff; indeed, Stott admitted as much (Tr. 965).

Moreover, BEDCO's cross-index of all securities traded by Stott reveals that as to seven, not six, of the issues, Stott was at the time in question recommending and buying the stocks for his non-discretionary accounts of other customers (see PX-25). With regard to three more of the stocks listed by Yamada, the cross-index shows that Stott bought the issues for other investment advisers as well as for Yamada. Finally, as to one issue which Yamada claimed Stott was recommending, defendants report that there is no record in the cross-index as to whether or not Stott bought this issue for others (see PX-25). While PX-25, standing alone, does not establish that Stott recommended each of the twelve issues for Rolf, the document does serve to credit the testimony of Yamada to the effect that Stott was involved with the decision to purchase the issues.^{3/} Accordingly, in light of all of the

^{3/} The Court notes that Yamada's testimony as to the twelve issues allegedly recommended by Stott was given before defendants produced the documents constituting the cross-index, PX-25.

findings hereinabove, and weighing all the evidence on the question, including the Court's observation of the demeanor of the witnesses, the Court concludes that Stott either recommended or was somehow involved with the decision to purchase the following twelve securities for plaintiff:

Simplex Wire & Cable Co.
Teradyne, Inc.
Standard Oil, N.J.
Reading & Bates Offshore
Intertherm, Inc.
Food Fair Properties
International Funeral
Natomas Corp.
Asamera Oil Corp.
Carter Wallace, Inc.
West Coast Production
Equity Funding Corp.

(PX-25; Tr. 518-530)

Accordingly, contrary to his testimony at trial, the Court finds that Stott was indeed involved with the management of the Rolf account, particularly during the first eight months of the complaint period.

One internal regulation at BEDCO prevented the trading of certain stocks through the firm. According to BEDCO's compliance officer, BEDCO would not solicit stocks which were selling at less than \$5.00 per share (Tr. 978-79). For this reason, as well as for reasons of his own, between May 1969 and March 1971, Yamada opened no less than eight other accounts in plaintiff's name at eight different brokerage firms. Plaintiff stated that he was almost completely ignorant as to why all these other accounts were being opened. Upon inquiry, he learned that

in some cases, Yamada had opened the accounts to give other broker associates some business; in other cases, Yamada opened the accounts to buy stocks from the firms that were engaged in underwriting new issues which BEDCO would not handle.

Despite these new accounts and the purchase and sale of stocks through those houses, Dr. Rolf was under the impression that BEDCO was looking after his portfolio as a whole. Indeed, the BEDCO account was a custody account, and in the great majority of cases where stocks were bought elsewhere by Yamada, Stott nevertheless received confirmation slips and the securities were delivered into BEDCO. Even though BEDCO received no commissions on these outside purchases, in a few cases the stocks were subsequently sold through BEDCO, producing commissions for Stott and his employer. According to Dr. Rolf, Stott assured him that BEDCO could still oversee the account since the stocks were often delivered in, and since confirmation slips were sent to Stott.

As Yamada's liquidation program quickly resulted in a wealth of new issues, many of which were over-the-counter stocks, Dr. Rolf was apparently both excited by the challenge of speculation and concerned over the strange names of the new issues. Beginning in July 1969, Rolf began calling Stott for assurance and for information about the new stocks. Stott testified that Rolf called him six or seven times per month from July 1969 through May 1970. Thereafter, Stott or his secretary called Rolf every day to give him quotations on the

over-the-counter prices. There is no evidence that Rolf and Yamada were in such frequent contact.

The testimony is consistent that Rolf called Stott to complain about the amount of trading and the nature of the stocks in the account. Stott stated that he simply told Rolf to speak to Yamada. However, plaintiff's version of the calls, which is supported by certain documentary evidence and by the testimony of Yamada, is that Stott continually assured Rolf with respect to Yamada's competence and ability, and that Stott repeatedly stated that if Yamada had decided to buy a stock, then Stott was sure that it was okay. Yamada referred to this arrangement as a procedure whereby if Rolf called him to complain, Yamada would call up Stott and tell Stott to speak to Rolf and "hold his hand." (Tr. 545) The Court finds that this was exactly what occurred.

Rolf believed that Stott was intimately involved with the management of the account. Indeed, since Stott and Yamada were in daily contact discussing securities which ended up in the plaintiff's account, Rolf's was a reasonable belief. It was moreover a correct belief; Stott was involved with the management of the account.

The period between May 1969 and January 1970 was characterized by the sale of the listed stocks and the purchase of very different issues. While there was some short-swing trading in U.S. Natural Resources between May 22 and 26, 1969 (DX-UU at 3), and while there was one short-swing trade of

International Funeral Services in December 1969 (DX-UU at 17), Yamada's program during that period was a gradual liquidation of the Stirling securities and the purchase of large quantities of unlisted and even restricted stocks. By the completion of the transformation in January 1970, the account stood as follows:

Delanair, Inc. (restricted)
Food Fair Properties, Inc.
Holobeam, Inc.
Monarch Industries, Inc.
Synchronex Corp.
West Coast Production Co.
Benquet Consolidated Corp.
Equity Funding Corp.
Outlet Company
Simplex Wire & Cable Co.

(DX-UU at 20)

In eight months, the value of Rolf's securities had dropped by over \$700,000. Further, while his net position was approximately \$712,000, \$338,000 of this was invested in Delanair, a restricted stock through which plaintiff was clearly defrauded by Yamada.

In August of 1969, Yamada persuaded Rolf to invest nearly \$400,000 in stock, calls and warrants of Delanair, Inc. The securities were purchased through BEDCO, but the parties all agree that the stock was initially Yamada's idea and that Stott received no commissions on the purchase. Rolf was concerned that the investment would tie up too large a portion of his money, so he telephoned Stott after he had spoken with Yamada but before the funds had been committed. Stott stated that if Yamada had

recommended the transaction, then it must be okay; in effect, Stott said to go through with it (Tr. 82). The Court does not accept Stott's statement to the effect that he never discussed the stock with anyone.

The lure of the Delanair investment was Yamada's representation to plaintiff that there would be a secondary or a public offering of the stock in six months and that Rolf would double or triple his investment thereby. Rolf stated at trial, and the Court finds, that Yamada's promise of a secondary offering was fraudulent.

Delanair never did achieve a secondary offering, and plaintiff found himself with restricted stock which rapidly declined in value. In 1972 Rolf brought a civil action against Delanair, Yamada, D.H. Blair & Co., and others; in 1973 that action was settled for \$175,000.^{4/} BEDCO was not a party defendant to that action (DX-NN through DX-QQ). When asked to assess the quality of the Delanair issue, plaintiff's expert witness described the stock as the "lowest of the low".

Four of the issues in plaintiff's BEDCO account as of January 1970 were, as the Court has found, bought on Stott's recommendation or with his participation: Food Fair, West Coast Production, Equity Funding, and Simplex Wire. Each of these stocks was eventually sold at a loss, the total amounting to over \$65,000. However, there is no evidence that any of these four stocks were unsuitable for Rolf.

^{4/} Thus, here plaintiff seeks damages of \$225,000 only by reason of the Delanair matter.

Monarch Industries was another substantial investment made by Yamada for Rolf in an obscure issue which resulted in a substantial loss. The stock was both bought and sold through brokerage houses other than BEDCO. Although Yamada stated that he discussed the stock with Stott between May and June 1969, he testified that the investment was his own decision. Rolf lost \$159,000 on the transaction (PX-24). Plaintiff's expert witness rated Monarch as "low quality".

Two other stocks bought in this period merit discussion, for they indicate the beginning of Yamada's trading for Rolf in securities which Yamada knew were being manipulated. The evidence is equivocal with respect to whether Holobeam, bought in January 1970, was manipulated, but Yamada testified that Synchronex Corp., purchased in October 1969, was a manipulated security. It is clear that neither Stott nor Rolf knew that these stocks were being used as vehicles to defraud others. Plaintiff's expert described the quality of these two stocks as "lowest of the low".

While there were many fewer trades in February and March 1970 than there had been in prior months, the market values of Delanair, Holobeam, Monarch and Synchronex declined drastically. On March 29, 1970, the net value of Rolf's account had fallen to \$446,000, nearly half of which was still in Delanair (See DX-UU at 22-24). Rolf by this time was becoming highly disturbed about his stocks, and as noted above, he began calling Stott on a regular basis. In early April 1970, Rolf

called Stott and complained that there had been in excess of five million dollars in transactions in the account since May 1969. For the first time Stott responded in writing, and for the first time Stott began to maintain that he was only an "order taker". In a letter dated April 10, 1970, Stott wrote to Rolf as follows:

"As you know, I have absolutely nothing to say over the management and handling of this account. When you signed your contract with Aki it gave him complete discretion. All I am with this account is basically an order taker.

"I think what you should do is sit down with Aki and spell out a complete program to help you recoup the losses that have been incurred in this account in the past year or so."

(DX-E)

Yamada stated that in his opinion this letter was false since Stott was much more than an order taker (Tr. 548). This was also Rolf's view as is seen from a letter written to Stott by Rolf in reply, dated April 15, 1970:

"Since you work closely with Aki, these are his plans for the near future:

1. The utilization of warrants and options as they come up.
2. A take out on Monarch Industries.
3. Placement of Delanair when the Secondary comes out.

* * * *

"In the meantime, I would appreciate your doing the following:

1. Have your secretary get a daily quote on my O-T-C securities.

2. Notify me promptly if there is a significant change up or down.
3. Keep me informed regarding any information you consider pertinent."

(PX-1)

Stott testified that while he did not make a written reply to this letter, he did call Rolf and stress that Yamada, and not the broker, was the one handling the account. However, it is clear from the correspondence that followed in the fall of 1970 that Rolf failed to get the message. In September, he sent Stott another letter detailing Yamada's plan for recouping losses (PX-2, PX-3). On October 7, 1970, Rolf wrote a letter to Stott which ended with the admonition: "Remember--you're my man in N.Y. Please keep the program on target." (PX-4).

Finally, on December 14, 1970, Rolf wrote to Stott asking him to "please keep your pulse on the situation and also keep me informed." (PX-5). Stott never wrote back to correct that which he now maintains was a continuing misimpression on Rolf's part as to BEDCO's duties.

Despite the fact that Yamada had opened eight new accounts for him, Rolf apparently was not content to leave the management of all of his securities to his adviser. In June 1969, Rolf had opened a non-discretionary account at Hornblower & Weeks Hemphill, Noyes, and over the following months he bought five issues there. The stocks were as follows:

American Scientific Corp.
Dasa Corp.
Data Network Mega Systems, Inc.
Ampex Corp.
Mohawk Data Science (DX R, DX R-1)

Rolf testified generally that he did not really know anything about these stocks. Indeed, plaintiff's own expert witness, on cross-examination, testified that Dasa Corp. was a "low quality" issue.

During this period, Yamada turned to even more speculative issues in order to make some profits for the plaintiff. He also began investing in issues which he testified were manipulated. According to Yamada, during the Delanair and Monarch ventures, Stott became concerned that there was a lack of trading in the account, and thus a lack of commissions. It is clear that Yamada had no interest in commissions for himself; his compensation was to come from a percentage of capital gains and further, Yamada was given the opportunity to employ Rolf's account as "buying power" for his own manipulations.

According to Yamada, in April 1970 Stott informed him that his superiors at BEDCO were becoming concerned about the Rolf account. However, this statement is not supported by any other evidence and thus the Court is not inclined to credit the testimony. Nevertheless, the Court does give some weight to Yamada's statement that Stott referred to the stocks in the Rolf account as "junk." (Tr. 542-44).^{5/}

^{5/} Again, Stott's testimony on the point is equivocal; Stott denied that he had ever threatened to tell Rolf about the "junk" in the account unless Yamada gave him more commissions; however, Stott stated that he did not know if he ever used the term "junk" to describe low quality securities (Tr. 842).

In brief, the Court concludes on this point that Stott did indeed consider many of the securities to be "junk" and that he told this to Yamada. However, it is clear that he never made such a statement to Rolf, and all parties agree that Stott never recommended against any purchase.

During 1970, Yamada bought for Rolf the following securities which Yamada knew were being manipulated, either before or shortly after the dates of purchase:

Visual Sciences, Inc.
Health Evaluation Systems
Hair Extension Centers
GPI Enterprises, Inc.
MH Studios
Tranquilaire Mental Health
Creative Polymer Products

Plaintiff's expert testified that in his opinion each of these stocks were "lowest of the low" quality. Many were new issues; all were highly speculative; public information was unavailable as to the majority of the issuers. Stott denied that he recommended any of these stocks, and Yamada testified that he traded in these stocks on his own. Five of the stocks were traded at other brokerage houses, and there is no credible evidence that Stott was aware of the fact that Yamada was using these stocks as vehicles to defraud. Further, Rolf was not the victim of the manipulations; Yamada made fairly substantial profits for Rolf on short-term trading in six of the seven manipulated stocks. Indeed, Yamada testified that in his opinion these stocks were suitable for Rolf (Tr. 696-702). For the reasons discussed within, the Court concludes otherwise.

Yamada also undertook further schemes in an attempt to recoup losses for Rolf through speculative ventures. Yamada and Rolf decided to sell Monarch Industries at a significant loss and invest the proceeds in the Takara Partners hedge fund. Yamada also continued to assure the plaintiff that Delanair would some day come through with its secondary offering. As late as September 1970, Rolf still apparently believed that he could regain his lost capital by speculative ventures, including "special situations", "new issues" and "founder's stock" (see PX-3). He wrote to Yamada by letter dated September 2, 1970, and indicated that he was continuing to discuss with Stott the question of Yamada's competence to achieve plaintiff's investment goals. In this letter Rolf began to once more emphasize the need for preservation of capital:

"For future endeavors in the years to come, it is obvious that we must again regain the same substantial base we started from. The old rule that the preservation of capital is the first rule of investment has never been more true."

(PX-3)

Through the end of the year 1970, as plaintiff's net position declined to \$225,000, Rolf continually sent to Stott copies of his correspondence with Yamada. It was during this period that Rolf referred to Stott as his "man in New York" and asked Stott to keep his pulse on the situation. However, in late January 1971, Rolf took the step of purchasing four conservative listed bank stocks through another broker at BEDCO.

Shortly thereafter, the SEC investigation of Yamada became public knowledge. BEDCO was visited by representatives of the Commission. BEDCO's chief compliance officer called Stott in and informed him that BEDCO would take no further orders from Yamada for the Rolf account. Shortly thereafter plaintiff was informed of the SEC investigation. The balloon of Yamada's manipulations was collapsing.

In his testimony at trial, Yamada described the functional aspects of the several manipulations involved in this lawsuit. Generally, Yamada along with a group of other money managers and underwriters would seek to obtain control of new, thinly-traded, over-the-counter securities. Once the group had purchased the great majority of the outstanding shares, they would begin to trade the stock up, by selling to each other at gradually higher and higher prices. Thus, the market price would be manipulated upwards, and other investors would become interested in the stock, thinking that the price rise was due to legitimate factors. At the end of the manipulation, the conspirators would sell out, leaving an unsuspecting group of investors with a large amount of artificially-inflated stock. Often, once the manipulators left the scene, the price of the stock would plummet, as was the case with Health Evaluation Systems (Tr. 624-25).

Yamada testified that he often assured Stott that these stocks were "under control" and that the price would "go up". Similarly, Yamada stated that he told Stott there

was a "box", a term Yamada used to encompass not only control over a given security, but also an illegal manipulation (Tr. 600-27). Stott testified that he knew nothing wrong about any of these stocks, in effect denying that he ever knew of the manipulations. Stott also denied ever hearing the term "box" used to imply or indicate a manipulation (Tr. 842-57). Faced with this direct conflict between Yamada and Stott's testimony, the Court chooses to discredit the allegations made by the investment adviser. However, as noted above, the Court does find that Stott knew these stocks were highly speculative, that they were "high-fliers" and that for the most part, they were "junk".

At trial, Stott described what he believed were his duties to Rolf during the period in question. In brief, Stott claimed that he was no more than an "order taker" whose job it was to add up the debits and the credits. Stott saw himself as a "bookkeeper" (Tr. 814) and he limited his supervisory activities to a five-minute monthly review of the plaintiff's statements (Tr. 821). Stott testified that he believed the phrase "my man in New York" in Rolf's October 1970 letter (PX-4) to mean that Rolf expected Stott to act as a diligent order taker (Tr. 833). He stated that to him, the phrase "please keep your pulse on the situation" in PX-5 meant that Rolf expected him to add up the debits and the credits accurately (Tr. 836). Stott stated that he never knew plaintiff's investment intent (Tr. 881-82). Stott also stated that

he never sent Health Evaluation or Hair Extension through BEDCO research to determine whether either was an appropriate investment for plaintiff (Tr. 901).

Stott and his employer maintain that they are relieved of almost every regulatory and fiduciary duty owed to Rolf solely because of the trading authorization executed by Rolf for Yamada. When asked by the Court to describe his view of his duties to a customer where the account was being traded by an investment adviser, Stott responded as follows:

"Unless there was something blatantly wrong with the order that I got from an investment adviser, or I had knowledge that this was, you know, something illegal was going on in the security, and if my firm permitted the order to be executed, I felt it was perfectly all right, yes. That is what I had been told." (Tr. at 863)

The testimony of BEDCO's chief compliance officer, John P. Cione, was to the same effect. As far as BEDCO was concerned in 1969-1970, if an investment adviser was in the picture, the brokerage firm was relieved from (1) the duty to investigate trading that appeared to be excessive; (2) the suitability of transactions made for the customer through the firm; and (3) the general duty to know the customer and learn the essential facts about him and his needs (see Tr. 1095).

Although BEDCO employed a computer-assisted program to detect excessive trading, and although that system was able to detect any monthly trading in any account which would exceed 3.5 if computed for an annual period, Cione testified

that once the compliance officer determined that the trading was occurring in an investment advisory account, no further questions would be asked (Tr. 1074). Further, said Cione, even had the officer gone further and spoken to Stott, the fact that Yamada was the adviser would have itself foreclosed further inquiry, due to Yamada's reputation at the time.

BEDCO did no study of any of the stocks bought for Rolf elsewhere and delivered into the custody account. While the firm did require that any stock with a rating below B-plus receive special research approval before a broker could recommend it, BEDCO did not apply any such "suitability" standard to stocks purchased in discretionary accounts run by investment advisers (Tr. 1049). Thus, despite the fact that many of the stocks bought for Rolf were not even listed in any rating manuals at all, and despite the fact that many of them were "high-flying" new issues which Yamada was manipulating, BEDCO never identified as unsuitable any security purchased for Rolf.

Thus, with the exception of the recommendations made by Stott in the early part of the period, it appears that the only services rendered to Dr. Rolf by Stott and BEDCO were trading the account and dutifully mailing to plaintiff confirmation slips. For these efforts the defendants BEDCO and Stott received commissions in a total amount of approximately \$42,000. Stott testified that his one-third share was only a small percentage of his total income in 1969-1970.

The Duties of Brokers

The registered representative of a broker dealer occupies a unique position in the scheme of securities regulation. Since he as broker is the person who actually trades securities for the investing public, his very employment is "in connection with the purchase and sale of securities." (Rule 10b-5). Indeed, a broker such as the defendant Stott conducts himself and carries out his daily routine through the instrumentalities of the national security exchanges and the over-the-counter market. (Rule 10b-5; Rule 15c1-2).

For these and related reasons, courts have concluded that the broker, by virtue of his position, owes a fiduciary duty to his customer. Moscarelli v. Stamm, 288 F.Supp. 453 (E.D.N.Y. 1968); Lorenz v. Watson, 258 F.Supp. 724 (E.D. Pa. 1966). See Carras v. Burns, 516 F.2d 251, 258 (4th Cir. 1975); Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969). Since brokers are traditionally compensated by commissions in direct proportion to purchases and sales, the opportunity to take advantage of the client is always present. To ensure that the broker fulfills his fiduciary duty, and to protect against frauds upon the customer, the broker and his employer are made subject to a series of obligations, the fraudulent breach of which may render them liable to the investor in damages. See Zweig v. Hearst Corp., 521 F.2d 1129, 1135 (9th Cir.), cert. denied, 423 U.S. 1025 (1975); Jacobs, The

Impact of Securities Exchange Rule 10b-5 on Broker Dealers, 57 Cornell L. Rev. 869 (1972). Among the possible liabilities involved in the instant action are damages for alleged violations of Rule 10b-5 and Rule 15c1-2, and of the rules of the New York Stock Exchange and of the National Association of Securities Dealers.

Rule 405 of the New York Stock Exchange provides in part as follows:

"Every member organization is required through a general partner, a principal executive officer or a person or persons designated under the provisions of Rule 342(b)(1) to

"(1) Use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization.

[and to]

"(2) Supervise diligently all accounts handled by registered representatives of the organization."

Article III, Section 2 of the Rules of Fair Practice of the National Association of Securities Dealers, Inc., provides as follows:

"In recommending to a customer the purchase sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

These rules and others impose a series of duties upon brokers which may be enforced through SEC enforcement actions and, increasingly, through private actions. While the rules of the NYSE and the NASD set forth duties which, by the language of the rules, appear to sound in negligence, when their breach operates in a manner tantamount to fraud, liability under Rule 10b-5 may be present. See Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 143 (7th Cir.), cert. denied, 396 U.S. 838 (1969).

The broker/customer relationship is rife with implied representations as to the broker's honesty, diligence and competence. It has been suggested that the failure to comply with the implied representations of due diligence and suitability can constitute a device or scheme actionable under Rule 10b-5. See Starkman v. Seroussi, 377 F.Supp. 518, 524 (S.D.N.Y. 1974) (Weinfeld, J.) As Judge Timbers wrote, albeit in an enforcement proceeding:

"Brokers and salesmen are 'under a duty to investigate, and their violation of that duty brings them within the term 'willful' in the Exchange Act.' Thus, a salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant The fact that his customer may be sophisticated and knowledgeable does not warrant a less stringent standard." (Hanly v. SEC, 415 F.2d 589, 595-96 (2d Cir. 1969) (footnote omitted)).

In this case Dr. Rolf claims that the defendants Stott and BEDCO breached fiduciary duties owed to him by virtue

of their position. Rolf also asserts Rule 10b-5 liability for churning, and secondary liability for aiding and abetting. Defendants' primary defense is the trading authorization.

Through their witnesses and in their submissions, defendants have argued that the trading authorization executed by Rolf operated to immunize BEDCO and Stott from all liability, and that it relieved them of the various regulatory and fiduciary duties described above. However, despite all these protestations and opinions rendered by the defendants with respect to the matter, the Court must note that defendants have cited absolutely no federal authority to support their argument that the presence of a trading authorization operates to relieve a member firm of its NYSE and NASD duties to its customers.

Rather, as Professor Jacobs has written, "contractual privity is not a sine qua non of broker liability." Jacobs, supra at 876.

License revocation proceedings before the Securities and Exchange Commission provide the most persuasive authority on the question. In In re William I. Hay, 19 S.E.C. 397 (1945), an investment adviser holding a power of attorney engaged in cross-trading and self-dealing, defrauding a number of clients whose stocks were traded through respondent's brokerage house. Further, the adviser bought for his clients large quantities of hopelessly speculative securities. In that proceeding, the brokers asserted the identical defense heard here--that they were fully authorized to accept directions from the adviser, that they never directly advised the

clients, and that the power of attorney insulated them from all direct brokerage duties to the clients. The Commission found the argument to be without merit.

Starting from the proposition that the respondent must have known of the adviser's frauds because they were self-evident, the Commission placed upon the brokers a duty of full disclosure to the customer. See 19 S.E.C. at 406-07. Further, the Commission concluded that the brokers had a duty to inform the clients concerning the speculative and financially unsound nature of the investments. The only alternative open to the respondents, the Commission concluded, was to refuse to accept further orders from the adviser.

"Respondents adopted neither course. The result was that the customers were utterly without protection--served by two agents, one with discretionary power over their account acting faithlessly, and the other a broker, knowing of the faithlessness yet claiming to be free of any duties." (Id. at 407).

A similar principle was announced by the Commission a few years later. In re Moore & Co., 32 S.E.C. 191 (1951), involved a situation where the adviser, one Furlong, manipulated the accounts of his clients through one Mrs. Ross, a broker with the respondent firm. Although she had engaged in cross-trading, simultaneous buying and selling, and other fraudulent transactions at Furlong's direction, the broker testified that she believed the adviser was authorized to engage in such activities. The Commission rejected the

notion that Mrs. Ross was relieved of her usual duties as a broker:

"Furlong's power of attorney to deal on behalf of his customers, rather than leading Mrs. Ross to believe, as she contends, that they authorized Furlong's conduct, should have made her realize that he was subject to a high standard of fiduciary responsibility and loyalty with which the transactions in question were on their face inconsistent. Under such circumstances, she could have insulated herself from responsibility only by making the fullest disclosures to his customers or by making certain that his conduct was actually authorized by his customers. She did neither." (32 S.E.C. at 196).

Drawing an inference of willfulness from the circumstances, the Commission determined that the broker's registration should be suspended.

Against the rather substantial thrust of these decisions, defendants present only a single case on point, Carroll v. Doolittle, 191 N.Y.S.2d 398 (Sup.Ct. Niagara Cnty. 1959). There the state trial court determined that a broker had no state law fiduciary duty to enquire behind the decisions of an investment adviser. This Court is constrained to reject Carroll and to accept the view of the Securities and Exchange Commission. While the precedent of SEC actions is not controlling in this civil suit for damages, the Court does find the Commission's decisions persuasive.

As the federal agency charged with the multifaceted duties of registration and regulation of broker dealers, as well as with the primary responsibility for enforcement of

securities laws designed to protect the investor, the Commission must be afforded the appropriate degree of deference and its administrative judgments accorded great weight. See SEC v. Chenery Corp., 332 U.S. 194, 209 (1947).

In this case there are additional reasons supporting the conclusion that the execution of the trading authorization did not operate to relieve Stott and BEDCO of their usual duties as brokers or to insulate them from liability under the securities laws. Here Dr. Rolf had for six years received from BEDCO the services of an investment adviser and a broker, through the offices of S. Logan Stirling. During that period BEDCO placed Rolf into aggressive but high quality investments. Rolf clearly expected, and the Court concludes he had a right to expect, that BEDCO would continue to exercise some informed judgment on his behalf during the Yamada period. Indeed, during this period Rolf had working for him at BEDCO one of the firm's largest producers, Stott, who had been a branch manager at two different BEDCO offices.

In addition, it was BEDCO, not Yamada, that was a member of the Stock Exchange and of NASD during the period in question. BEDCO, as a large firm in a highly regulated business, was required to implement a series of safeguards to protect its customers. Yamada was associated with no brokerage firm and, as far as the Court is aware, had no direct access to any research department. Despite his

credentials and his reputation at the time, Yamada was not in any position and had no express obligation to perform for Dr. Rolf each of the assorted duties imposed upon broker dealers by the NYSE and NASD rules.

Further, even if in the abstract a trading authorization relieves the broker from his usual supervisory and due diligence duties, here the conduct of the defendant Stott resulted in his direct participation in the management of the account. While Yamada had the authorization, the Court has found that Stott influenced Yamada's decision-making and recommended to Yamada stocks for Rolf. By these actions, Stott himself pierced the veil of any protection the power of attorney might have given to him or to BEDCO. A broker cannot recommend stocks to an investment adviser at will and then back off and claim he was no more than an "order taker" when such judgments are challenged.

Finally, the Court notes that defendants are unable to point to any language in the NYSE rules which indicates that the duties of a broker are lessened when an investment adviser handles the account. Indeed, the language of Rule 405(1) which requires the broker to discover all pertinent facts with respect to the adviser indicates to this Court that due diligence is required in this situation also.

Accordingly, under the facts and circumstances herein, and upon the authority of the decisions discussed above, the Court concludes that the execution of the trading authorization

in this case did not relieve BEDCO or Stott from their duties to supervise the account and to employ due diligence with respect thereto.

Churning

When a broker engages in excessive trading in disregard of the customer's investment objectives for the purpose of generating commission business, the customer may hold the broker liable for "churning" the account in violation of Rule 10b-5. See Carras v. Burns, 516 F.2d 251, 258 (4th Cir. 1975); Greenfield v. D.H. Blair & Co., [1975-76] CCH Fed.Sec.L.Rep. ¶95,239 (S.D.N.Y. 1975). As part of his proof, plaintiff must also demonstrate scienter, that is, that the broker acted with intent to defraud or with a willful and reckless disregard for whether his actions constituted fraud. Ernst & Ernst v. Hochfelder 425 U.S. 185, 193 (1976); Lanza v. Drexel & Co., 479 F.2d 1277, 1306 (2d Cir. 1973) (en banc); see Arthur Lipper Corp. v. SEC, No. 76-4067 (2d Cir. Dec. 10, 1976), Slip Opin. 901 at 918.

To prevail on this claim, plaintiff must show not only that the trading in his account was excessive under the cases, but further that the amount of the trading was unjustified in light of his investment objectives. Van Alen v. Dominick & Dominick, 71 Civ. 5438 (S.D.N.Y. December 22, 1976); Newburger, Loeb & Co. v. Gross, 365 F.Supp. 1364, 1371 (S.D.N.Y. 1973); Hecht v. Harris Upham & Co., 283 F.Supp. 417, 435 (N.D. Cal. 1968), modified on other grounds, 430 F.2d 1202 (9th Cir. 1970).

Here the plaintiff has failed to establish the first

element of churning, that of excessive trading. During the period of the complaint, the annual turnover rate, even as calculated by the plaintiff, was never any higher than 1.85. This is not excessive under the decisions. See Van Alen v. Dominick & Dominick, supra; Moscarelli v. Stamm, 288 F.Supp. 453 (E.D.N.Y. 1968); Hecht v. Harris, Upham & Co., supra. Indeed, it is the view of at least one commentator that an annual turnover rate will not be considered excessive unless it begins to approach six. See Note, Churning by Securities Dealers, 80 Harv.L.Rev. 869 (1967).

The Court's finding that the turnover was not excessive is confirmed by the other circumstances present in the case. First, much of the turnover during the year 1969 came as a result of Yamada's liquidation of the Stirling securities, a major overhaul of the account which plaintiff approved. Further, it is clear that plaintiff expected that the proceeds of the liquidation would be used for "trading" rather than for long-term investment. See PX-3. As the foregoing factual discussion indicates, plaintiff's primary goal was capital growth; he was willing to take the risks involved in short-term trading, and he never instructed Yamada not to engage in short-swing trades. Plaintiff's twice-stated investment intent was to double his equity; indeed, in 1969 he expected his equity to double in approximately one year. In brief, the Court concludes that Dr. Rolf was a trader, not an investor, and that he is now estopped from maintaining that there was excessive trading in his account.

See Landry v. Hemphill, Noyes & Co., 473 F.2d 365 (1st Cir. 1973).

While the presence of Yamada does not operate to relieve Stott and BEDCO of their duties as brokers, the fact that the adviser made the majority of the investment and trading decisions militates against any finding that Stott traded the account in order to generate commission business. At trial, Yamada set forth his own reasons for many of the transactions herein, and while Yamada's reasons were not entirely legitimate--involving as they did "free-riding" stock manipulations--it is clear that the trades were not without some investment purpose. Further, Stott did not have exclusive control over the buy and sell decisions, even though he had some influence upon Yamada's decision-making process. A finding that the broker had virtually exclusive control over the trading is a necessary prerequisite to liability for churning. See Carras v. Burns, 516 F.2d 251, 258 (4th Cir. 1975); Greenfeld v. D.H. Blair & Co., supra; Hecht v. Harris Upham & Co., supra, 283 F.Supp. at 433; see also Newburger, Loeb & Co. v. Gross, [Current Binder] CCH Fed.Sec.L.Rep. ¶95,649 (S.D.N.Y. July 8, 1976). Accordingly, the churning claim must be dismissed.

Rules Violations

Since the Court has concluded that the defendant Stott was not aware of the manipulations in the Rolf account and that Stott did not churn the account, plaintiff's only remaining claims are based upon alleged violations of the NYSE

and NASD rules. Accordingly, the Court must enquire into the open question of whether or not an investor may prevail in a private cause of action based upon violations of the regulatory rules.

In Colonial Realty v. Bache & Co., 358 F.2d 178 (2d Cir. 1966), the court concluded that no private cause of action could be brought under the Exchange Act to hold a broker liable in damages for failure to employ "just and equitable" principles of trade, as required by the NASD rules. The court reasoned that such liability would too closely parallel the common law, and that the concept of "just and equitable" principles of trade was so vague and broad that enforcement would be impossible. However, the Second Circuit in Colonial Realty did not foreclose the possibility that NYSE or NASD rules might support a federal securities action in this court; indeed, the court indicated that in considering the question, one must look to the nature of the particular rule and its place in the regulatory scheme. Further, the court stated that the case for implication of a right of action would be strongest where the rule set forth a duty unknown at common law. 358 F.2d at 181-83.

Applying these or comparable principles, a series of decisions have accepted the proposition that in an appropriate case, violations of exchange rules designed for investor protection might give rise to a private cause of action. See Ocrant v. Dean Witter & Co., 502 F.2d 854, 858 (10th Cir. 1974); Buttrey

Merrill, Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 141 (7th Cir.), cert. denied, 396 U.S. 838 (1969) (NYSE Rule 405 held actionable); Avern Trust v. Clarke, 415 F.2d 1238, 1242 (7th Cir. 1969), cert. denied, 397 U.S. 963 (1970) (NASD rules actionable).

While the parties have not cited, and the Court's research has not found, any reported decision which has held a broker liable solely for the violation of NYSE or NASD rules, a series of district court decisions have accepted the proposition that such liability may lie, and the cases have fashioned the contours of liability for rules violations.

In this district, Judge Weinfeld has expressly held that violations of NYSE rules 345 and 405 are actionable. See Starkman v. Seroussi, 377 F.Supp. 518 (S.D.N.Y. 1974). Another decision refused to find actionable one NASD rule that imposed the duty to keep proper books, reasoning that the NASD rule, like that considered in Colonial Realty, was too vague to be enforceable. Gurvitz v. Bregman & Co., 379 F.Supp. 1283 (S.D.N.Y. 1974). Another decision in this district dismissed claims of rules violations where the allegations of the complaint did not set forth a claim of fraud. Bell v. J.D. Winer & Co., 392 F.Supp. 646 (S.D.N.Y. 1975) (Tyler, J.). A recent decision by Judge Newman in the District of Connecticut has concluded that violations of the NYSE and NASD rules are not actionable. Plunkett v. Dominick & Dominick, Inc. [Current Binder] CCH Fed.Sec.L.Rep. ¶95,728 (D. Conn. April 27, 1976); see also

Zagari v. Dean Witter & Co. [Current Binder] CCH Fed.Sec.L.Rep. ¶95,777 (N.D. Cal. Sept. 27, 1976).

The starting point of the analysis is an inquiry into the place which the specific rules occupy in the entire regulatory scheme. In this regard, the Court notes that the Securities and Exchange Commission has enacted regulations comparable to the suitability and the supervisory rules of the NYSE and the NASD; see 17 C.F.R. §§240.15b10-3 and 240.15b10-4 (1976); Plunkett v. Dominick & Dominick, Inc., supra, ¶95,728 at 90,562 n.5. With respect to the types of duties imposed by the language of the NYSE and NASD rules themselves, the Court agrees with Judge Weinfeld's reasoning in Starkman v. Seroussi, supra, and concludes that NYSE Rule 405 and Article III, Section 2 of the NASD rules are sufficiently precise to sustain a cause of action. Further, there can be no doubt that the purpose of these rules is to protect the investor. Finally, since particularly in this action the duties imposed upon the defendants may be unknown at common law, see Carroll v. Doolittle, supra, the Court concludes that this action presents a strong case for the implication of a civil right of action under the NYSE and NASD rules.

Since Rule 10b-5 and 15c1-2 of the Exchange Act are directed essentially at fraud, any definition of what is actionable under NYSE Rule 405 and Art. III §2 of NASD should be narrowly drawn. See Hecht v. Harris Upham & Co., supra, 283 F.Supp. 417, 430. Indeed, each court that has considered

the question has concluded that mere negligent violations of the NYSE or NASD rules are not actionable in federal court; rather, to form the basis for liability in damages, the broker's violations of the rules must be "tantamount to fraud". See Buttrey v. Merrill Lynch, supra, 410 F.2d at 143; Bell v. J.D. Winer, supra; Geyer v. Paine Webber Jackson & Curtis, Inc., 389 F.Supp. 679 (D. Wyo. 1975) (mere negligence insufficient); Wells v. Blythe & Co., 351 F.Supp. 999, 1001 (N.D. Cal. 1973) (rules violations not "per se" actionable); McCurnin v. Kohlmeier & Co., 347 F.Supp. 573 (E.D. La. 1972) (plaintiff must prove at least a knowing and callous disregard for the rules).

Accordingly, the Court concludes that under the circumstances of this case, plaintiff may assert a cause of action for violation of the "know your customer" requirement of NYSE Rule 405, and the supervision and suitability requirements of that Rule and of Art. III §2 NASD and may prevail upon such a claim if he proves by a preponderance of the evidence that the actions of Stott and BEDCO constituted violations of the applicable rules "tantamount to fraud". To meet this standard in this case would mean that the violations operated as a fraud upon the plaintiff and that the defendants acted with scienter, that is, with intent to defraud or with willful and reckless disregard for the truth or falsity of their representations or of whether their actions constituted a fraud. See Lanza v. Drexel & Co., supra; see also Arthur Lipper Corp. v. SEC, supra.

The Court readily concludes that the actions of the three defendants operated as a fraud upon Dr. Rolf. Initially, the Court has found that Yamada's actions with respect to Delanair operated as a fraud upon the plaintiff. Further, the Court concludes that Yamada's handling of the Rolf account was generally of a fraudulent nature. Indeed, on the facts of this case, the Court has no doubt that the securities purchased by Yamada as a part of his manipulative schemes were unsuitable for the plaintiff. Finally, the complete transformation of the Rolf account from one containing 23 listed issues of reputable quality to an account made up of the likes of Hair Extension Centers, Health Evaluation Systems, and M.H. Studios evidences a breach by Yamada of his investment advisory duties which is doubtless "tantamount to fraud".

In such circumstances, where the plaintiff was being disserved by a faithless investment adviser who was interested in his account only for its "buying power", the "hand-holding" operation successfully accomplished by Stott was, under the circumstances, a fraud upon the plaintiff.

First, Stott admitted that he never knew plaintiff's investment intent, and that he had no idea what type of investor this customer was when he recommended Yamada to Rolf. These admissions alone could suffice to form the basis of a violation of NYSE Rule 405(1) tantamount to fraud. Contrary to the clear requirements of that Rule, Stott totally failed to

learn the essential facts relative to Rolf and Rolf's account. Stott also failed to learn every essential fact relative to Yamada, since he did not learn whether Yamada would be a suitable adviser for Dr. Rolf.

Second, Stott's practice of continually voicing his confidence in Yamada and in Yamada's investment decisions constituted a fraud upon Dr. Rolf, who sincerely believed that Stott had some basis for his statements. The statements of support and the assurances which were repeatedly made were made with willful and reckless disregard for whether they were true or false. While Stott may have had a strong belief in Yamada's money-making abilities, he certainly knew, as the Court has concluded, that Yamada was continuing to invest plaintiff's money in "junk" even after plaintiff had lost three-quarters of a million dollars through such ventures. The evidence is clear that Stott never once recommended that Rolf reconsider any transaction. Stott never recommended against any investment. Stott never suggested to Rolf that perhaps Yamada was too speculative for the plaintiff's investment needs. Stott totally failed to perform the duties placed upon him, as a registered representative and as an employee of a member firm, to take adequate steps to protect the interests of a customer who had entrusted his securities account to BEDCO for six years. Accordingly, the Court concludes that Stott's actions were tantamount to fraud, since they deceived plaintiff into thinking that BEDCO was protecting his interests, and since

they operated to help conceal from Rolf the fraud being perpetrated by Yamada.

For the same reasons, the Court concludes that plaintiff has proved by a preponderance of the evidence that Stott acted with the requisite scienter. Stott recommended a number of issues for Rolf's account without ever knowing Rolf's investment intentions. He recommended Yamada without any knowledge about plaintiff's account. He continually held Dr. Rolf's hand and assured him, without any basis in fact, that Yamada's decisions were good for Rolf. The Court finds that these factors constitute a knowing, willful and reckless disregard for the truth, a callous and knowing disregard for the requirements of the NYSE and NASD rules involved herein, and proof of the scienter element by a fair preponderance of the credible evidence. This conclusion is based upon all the evidence in the case, as well as upon the Court's assessment of Stott's demeanor and credibility.

Even had Stott never assured the plaintiff with respect to Yamada, Stott's total failure to speak out nevertheless would suffice to render him liable for violations of the rules. Stott not only failed to learn about Rolf, but he totally failed to investigate the stocks in the account or to tell Rolf what he now claims--that he really didn't know anything about those stocks. If a broker acts only as an order-taker, he must not offer advice. If he begins to offer advice, he must not fail to make full disclosure. Carrass v. Burns, 516 F.2d 251, 258

(4th Cir. 1975). It is apparent that Stott "deliberately closed his eyes to facts he had a duty to see . . . or recklessly stated as facts things of which he was ignorant." Dlugash v. SEC, 373 F.2d 107, 109 (2d Cir. 1967).

A broker must not allow his silence to be taken as a recommendation. If he cannot or will not investigate the security being purchased, he must disclose the fact to the customer and warn the customer of the risks of making investments without full knowledge of the issuer. He must satisfy himself that not only the security but also the type of transaction is suitable for the customer. See Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969); Jacobs, supra at 887-93. It is apparent that "securities issued by smaller companies of recent origin . . . require more thorough investigation." Hanly, supra at 597. Here, Stott testified that he never sent Yamada's speculative investments through BEDCO research to determine whether they were suitable.

For the foregoing reasons, the Court concludes that Stott is liable to the plaintiff in damages for violations of NYSE Rule 405 and Art. III §2 of the NASD Rules.

Aiding and Abetting

Plaintiff's complaint further asserts that Stott is liable to the plaintiff for aiding and abetting the fraud Yamada perpetrated upon the plaintiff. In order to sustain this claim, the plaintiff must prove that an independent wrong existed, that the alleged aider and abettor had knowledge of the wrong,

that he acted with scienter, and that he rendered substantial assistance to the primary wrongdoer. Lowenschuss v. Kane, 520 F.2d 255, 268 n.10 (2d Cir. 1975); SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974); H.L. Federman & Co. v. Greenberg, 405 F.Supp. 1332 (S.D.N.Y. 1975); Rosen v. Dick [1974-75] CCH Fed.Sec.L.Rep. ¶94,786 (S.D.N.Y. Sept. 3, 1974).

As the Court has observed above, the plaintiff has proven that Yamada defrauded the plaintiff through the Delanair transaction and that he breached his own fiduciary duties owed to the plaintiff by reason of his investment advisory agreement. These violations were not merely "tantamount to fraud" but rather constituted a gross fraud. Thus, plaintiff has established an independent wrong by Yamada in violation of Rule 10b-5.

The Court has concluded that Stott knew of the nature of the securities which were being purchased in the account. Stott was aware that Yamada was purchasing highly unsuitable stocks, or "junk", even after such transactions had resulted in the loss of half of plaintiff's money. Even though Stott did not know of the direct frauds which Yamada was perpetrating on Rolf--such as Delanair--he must have known of the egregious violations by Yamada of the suitability rule. Accordingly, the Court concludes that plaintiff has established Stott's knowledge of the wrongful acts.

For the same reasons as detailed in the previous section, the Court concludes that Stott acted with scienter; that is, he made representations to the plaintiff with willful

and reckless disregard for their truth, and he acted with a callous and knowing disregard for the requirements of the NYSE and NASD rules.

Finally, there can be little doubt that Stott afforded substantial assistance to the primary wrongdoer Yamada. By continually holding Rolf's hand and assuring him that Yamada's decisions were appropriate, Stott substantially diminished any opportunity for an earlier discovery by Rolf of Yamada's true intentions. By failing to recommend against any venture and by failing to encourage Rolf to question Yamada's suitability as an adviser, Stott contributed to the perpetration of the depletion of Rolf's account and the accumulation of unsuitable securities therein. By trading the stocks through BEDCO with nary a thought as to their suitability or their legitimacy, Stott gave to Yamada what he needed: access to a large portfolio which could be used as a tool in his manipulations. Accordingly, the Court concludes that Stott is liable to the plaintiff for aiding and abetting Yamada's fraudulent violations of his own duties as an investment adviser.

BEDCO's Liability

Plaintiff further asserts that defendant BEDCO is liable for failure to supervise Stott and the Rolf account, either under the doctrine of respondeat superior or as a controlling person liable under Section 20 of the Exchange Act.

Four circuit courts have concluded that a brokerage firm may be liable to a defrauded customer under the common law

principle of respondeat superior. See Holloway v. Howerd, [Current Binder] CCH Fed.Sec.L.Rep. ¶95,629 (6th Cir. June 16, 1976); Fey v. Walston & Co., 493 F.2d 1036 (7th Cir. 1974); Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973) (Wisdom, J.); John Hopkins University v. Hutton, 422 F.2d 1124 (4th Cir. 1970), cert. denied, 416 U.S. 916 (1974). In this Circuit, two decisions have indicated a growing willingness to hold a brokerage firm liable, at least in enforcement actions, on the basis of the common law principle. See SEC v. Geon Industries, Inc., No. 74-2614 (2d Cir. February 9, 1976) (Friendly, J.); SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975) (Kaufman, C.J.). Management Dynamics expressly disapproved of one district court decision which held respondeat superior inapplicable to a brokerage house, SEC v. Lums, Inc., 365 F.Supp. 1046 (S.D.N.Y. 1973). See 515 F.2d at 811-13. Further, it has been suggested that certain language in Geon Industries, supra, signals the application of respondeat superior to brokerage firms in damages actions. See Plunkett v. Dominick & Dominick, Inc., supra, ¶95,561 at 90,561 (concluding that the common law principle applies).

On the basis of this discussion and the thrust of the cases, this Court concludes that defendant BEDCO is liable to plaintiff under the rule of respondeat superior. There can be no doubt that Stott's actions were within the course of his employment. See Lewis v. Walston & Co., supra, 487 F.2d 617 (5th Cir. 1973); Restatement of the Law of Agency (2d) §229; see

also Goodman v. H. Hentz & Co., 265 F.Supp. 440 (N.D. Ill. 1967)).

The Court also finds BEDCO liable for failure to supervise the account, pursuant to Section 20 of the Exchange Act. The difference between respondeat superior and controlling person liability is "not entirely esoteric" since there is a good faith defense to the latter charge which is unavailable at common law. See Plunkett v. Dominick & Dominick, supra.

However, here BEDCO's compliance officer stated that all of the firm's control procedures to guard against churning and against unsuitability were jettisoned in the face of an investment adviser--any investment adviser. Under the decisions of the SEC in In re William I. Hay, 19 S.E.C. 397 (1945) and In re Moore & Co., 32 S.E.C. 191 (1951), the Court concludes that BEDCO's system of supervision during the time in question was wholly insufficient to guard against fraud by the investment adviser or by the broker who was trading for an investment adviser

"With considerable unanimity, the reported cases have required that to satisfy good faith it must be shown that the controlling person maintained and enforced a reasonable and proper system of supervision and internal control over controlled persons so as to prevent, so far as possible, violations of Section 10(b) and Rule 10b-5." (Zweig v. Hearst Corp., 521 F.2d 1129, 1134-35 (9th Cir.), cert. denied, 423 U.S. 1025 (1975))

Although BEDCO did not have actual notice of the fraud, its acknowledged policy with respect to the firm's duties where an investment adviser is present, its complete.

failure to supervise any such accounts, and its laxness which went so far as to permit Stott to recommend an investment adviser with no knowledge of Dr. Rolf's account and even further to allow some unidentified person to trade in Rolf's account during April 1969, all lead the Court to the conclusion that BEDCO did not, during the period in question, establish even minimally sufficient safeguards to protect the investor from the type of fraud present in this case. Accordingly, the good faith defense has not been established. See Barthe v. Rizzo, 384 F.Supp. 1063 (S.D.N.Y. 1974).

Damages

Plaintiff has established that the acts of the defendants were a substantial or proximate cause of the placing of unsuitable securities in his BEDCO account. Stott's conduct and BEDCO's failure to supervise created a continuous and active potential for harm to the plaintiff, see Miller v. Schweickart, 413 F.Supp. 1062 (S.D.N.Y. 1976), and it is clear that plaintiff was damaged as a proximate result of the defendants' fraud.

However, a persistent damages question in cases such as this one is whether the plaintiff can recover his net losses from the broker who failed in his duties. Having carefully considered the matter, the Court determines that the measure of damages for violation of the suitability and supervision rules should be the same as that applied by the federal courts in awarding damages for churning, i.e., the quasi-contractual

logical measure of damages is to require the defendants to return all the benefit which they received, since they failed to give to plaintiff the consideration due him--supervision and diligence as to the account. Under the circumstances of this case, all other measures of damage are rejected as wholly speculative with respect to actual injury found by the Court to have been caused by the defendants' actions.

Plaintiff's complaint alleges that during the period in question, the defendants were paid by plaintiff commissions in the amount of \$42,341.80 and interest on the margin account of \$13,448.20. These figures were mentioned by the various witnesses at trial, and the sums are compiled from BEDCO statements (PX-12, PX-13, PX-14). The Court considers an award of commissions and margin account interest to be proper in this case, since it restores to the plaintiff all monies paid to the defendants Stott and BEDCO during the period in question.

Plaintiff also makes a post-trial claim for punitive damages, but the Court declines under the circumstances to grant such an application. First, there is no dispute that plaintiff's complaint set forth no cause of action under state law; despite the decisions cited by the plaintiff; see Henry v. United States, 424 F.2d 677 (5th Cir. 1970), the Court would not be willing to grant an application to amend the pleadings at this late date. In any event, the point is academic since the Court does not find that an award of exemplary damages should be granted in this case.

First, there is substantial doubt as to whether a plaintiff can ever receive punitive damages for violations of federal securities laws. See Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), cert. denied, 395 U.S. 977 (1969); Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert denied, 390 U.S. 951 (1968). Even assuming that there was no procedural or statutory obstacle to the grant of punitive damages, the Court would not make such an award based upon the rationale stated by the court in Stevens v. Abbott, Proctor & Paine, supra:

"The Court finds that the conduct engaged in in the instant case results from the failure of the defendants to abide by their legal responsibilities, but finds no reason to believe that by awarding exemplary or punitive damages, actions in the future similar to those which give rise to the instant suit would be any more deterred than by virtue of the fact that the suit itself has accomplished that very result." (288 F.Supp. 836, 848)

Accordingly, plaintiff shall recover commissions and interests paid on the margin account, plus interest from the date of the entry of judgment herein. See Stevens v. Abbott, Proctor & Paine, supra.

The Cross-Claims Against Yamada

The Court concludes that a broker and his employer should not be permitted to receive indemnity from the customer's investment adviser where the broker and his firm have failed in their duty to protect the interests of the customer, in violation of NYSE and NASD rules and in violation of Rule 10b-5. To allow

indemnity in this case would be to encourage flouting the policy of the securities laws. See Globus v. Law Research Service, Inc., 418 F.2d 1276, 1288 (2d Cir. 1969), cert. denied, 397 U.S. 913 (1970). Accordingly, the cross-claims against Yamada are dismissed.

Conclusion

Judgment should be entered for the plaintiff David E. Rolf against defendants Blyth Eastman Dillon & Co., Inc., and Michael Stott for damages in the amount of \$55,790.00 plus interest from the date of judgment, in accordance with the decision of the Court herein. Judgment should further be entered dismissing plaintiff's claims against the defendant Akiyoshi Yamada in accordance with the stipulation and order entered at the conclusion of trial, and dismissing the cross-claims of defendants BEDCO and Stott against Yamada. Counsel for the plaintiff is directed to submit an appropriate order of judgment on three days' notice.

SO ORDERED.

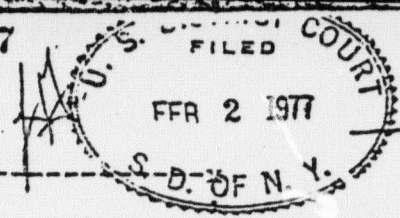
Dated: New York, New York
January 17, 1977

LAWRENCE W. PIERCE
U. S. D. J.

Closed

Final Judgment
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JA 77



DAVID E. ROLF,

Plaintiff, : 73 Civ. 2967
(L.W.P.)

- v -

BLYTH EASTMAN DILLON & CO., INC.,
AKIYOSHI YAMADA and MICHAEL STOTT,

: ORDER AND FINAL
JUDGMENT

: # 77,243

Defendants. :

-----X

WHEREAS, this action came on for trial before the court, Honorable Lawrence W. Pierce presiding who rendered a decision on January 17, 1977, (Decision) adjudging that defendant Blyth Eastman Dillon & Co., Inc., (BEDCO) and Michael Stott (Stott) had violated Section 10b and Section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. §§78j(b) and 78o(c)(1)) and Securities and Exchange Commission Rule 10b-5 and Rule 15c1-2 (17 C.F.R. §§240.10b-5 and 240.15c1-2) thereunder by violations tantamount to fraud of Rules 405(1) and (2) of the New York Stock Exchange and Article III, Section 2 of the rules of the National Association of Securities Dealers, Inc., that Stott violated Rule 10b-5 and Rule 15c1-2 as an aider and abettor, that BEDCO, as a controlling person of Stott is liable for Stott's violations under Section 20 of the Exchange Act (15 U.S.C. §78t) and that BEDCO is liable under the common law principle of respondeat superior for Stott's violations; that Stott and BEDCO are liable jointly and severally to plaintiff for damages of \$55,790 plus interest from the date of judgment; and

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FEB 7 - 1977

WHEREAS, BEDCO and Stott had asserted cross-claims against Akiyoshi Yamada (Yamada) which claims the Decision finds to be without merit and directs that they should be dismissed with prejudice; and

WHEREAS, plaintiff has stipulated to dismiss without prejudice and without costs the complaint as against defendant Yamada and the Decision finds that the aforesaid stipulation should be implemented by an appropriate Order and Judgment;

NOW, IT IS:

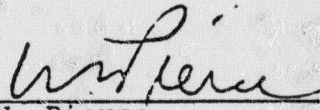
ORDERED, ADJUDGED AND DECREED, that plaintiff recover from defendants BEDCO and Stott the sum of \$55,790 plus interest from the date of Judgment; and it is further

ORDERED, ADJUDGED and DECREED, that the cross-claims asserted by BEDCO and Stott against Yamada be dismissed with prejudice; and it is further

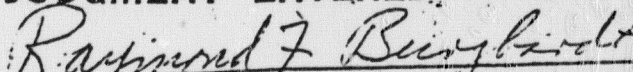
ORDERED, ADJUDGED and DECREED, that the complaint be dismissed without prejudice and without costs as against defendant Yamada; and it is further

ORDERED, ADJUDGED and DECREED, that the costs of the action be taxed against defendants BEDCO and Stott.

Dated: New York, New York
January 31, 1977


Lawrence W. Pierce
United States District Judge

JUDGMENT ENTERED - 2/3/77


CLERK

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JA 79

-----X
DAVID E. ROLF,

Plaintiff,

-against-

BLYTH EASTMAN DILLON & CO., INC.,
AKIYOSHI YAMADA and MICHAEL STOTT,

Defendants.
-----X

73 Civ. 2967 (LWP)

NOTICE OF APPEAL

Notice is hereby given that David E. Rolf, plaintiff above named, hereby appeals to the United States Court of Appeals for the Second Circuit from the first decretal paragraph of the Order and Judgment, entered on February 3, 1977, which awarded plaintiff his broker's commissions and certain interest expense, and denied to plaintiff a recovery based upon his actual losses and pre-judgment interest.

SILVERMAN & HARNES,

By: *Sidney B. Silverman*

A Member of the Firm
Attorneys for Plaintiff
75 Rockefeller Plaza
New York, New York
10019

Dated: New York, New York
February 22, 1977

TO: BREED ABBOTT & MORGAN, ESQS.
Attorneys for Defendants
Blyth Eastman Dillon & Co., Inc.
and Michael Stott
One Chase Manhattan Plaza
New York, New York 10005

BARRY A TESSLER, ESQ.
Attorney for Defendant
Akiyoshi Yamada
110 East 59th Street
New York, New York 10022

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

US District Court
Filed JA 79A
MAR 7, 1977
S D of NY

----- x
DAVID E. ROLF,

: 73 Civ. 2967 (LWP)

Plaintiff,

:

-against-

: NOTICE OF CROSS-APPEAL

BLYTH EASTMAN DILLON & CO., INC.,
AKIYOSHI YAMADA and MICHAEL STOTT,

:

:

Defendants.

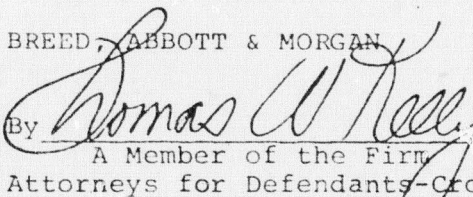
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Notice is hereby given that Blyth Eastman Dillon & Co., Inc. and Michael Stott, two of the defendants above named, hereby cross-appeal to the United States Court of Appeals for the Second Circuit from the Decision entered on January 18, 1977, and related Order and Final Judgment, entered on February 2, 1977, except insofar as said Decision and Order (1) dismissed any and all churning claims asserted by plaintiff against defendants Blyth Eastman Dillon & Co., Inc. and Michael Stott, (2) dismissed with prejudice the cross-claims asserted by Blyth Eastman Dillon & Co., Inc. and Michael Stott against defendant Akiyoshi Yamada, and (3) dismissed the complaint without prejudice against defendant Akiyoshi Yamada.

Dated: New York, New York
March 7, 1977.

BREED, ABBOTT & MORGAN

By 

A Member of the Firm
Attorneys for Defendants-Cross-
Appellants Blyth Eastman
Dillon & Co., Inc. and
Michael Stott
One Chase Manhattan Plaza
New York, New York 10005
(212) 676-0800

TO:

SILVERMAN & HARNES, ESQS.
Attorneys for Plaintiff
75 Rockefeller Plaza
New York, New York 10019

rk:mg

Rolf - direct

* * *

DIRECT EXAMINATION

BY MR. SILVERMAN:

Q What is your principal occupation?

A I am a physician and surgeon.

Q Do you specialize in any field?

A Yes.

Q In what field do you specialize?

A Ophthalmology.

Q Would you describe the training that you underwent prior to becoming a specialist in the field of ophthalmology?

A Yes.

I spent four years in medical school, one year rotating internship, and four years post-graduate work.

Q Is it necessary for you to engage in any post-graduate education to keep abreast of developments in the field of ophthalmology?

A Yes.

Q Do you do so?

A Yes.

Q Would you describe those studies?

A The new law requires that we spend a lot of extra time in post-graduate work. We are required to have at least 50 hours a year, and we have to attend various

* * *

Q When you first began to invest in the market, did you have an investment objective?

A Yes.

Q What was your investment objective?

A Well, I was starting out and I wanted capital growth and I wanted to preserve my capital, too.

Q Have you stated your objectives in the order of their importance?

A Yes. I wanted capital growth first because I was getting started and security was the second thing.

Q Did you have a procedure for the selection of securities?

A Yes.

Q Would you describe the procedure which you had?

A Well, various brokers would call me with their recommendations and I would make decisions to the best of my ability.

Q Did you have a procedure for selecting brokers who would call you?

A Yes.

Q What was that procedure?

A I would act on the recommendation of my friends.

Q Your friends would recommend brokers?

A They would recommend different brokers.

1
2 Q During what period of time was this procedure
3 that you have just described; namely, acting upon the
4 recommendation of brokers, how long did that last?

5 A Twelve years.

6 Q From 1950 to 1962?

7 A Yes.

8 Q Were you satisfied with the procedure that you
9 have just described for the selection of investment during
10 the period 1950 to 1962?

11 A No.

12 Q What was your reason or reasons for being dis-
13 satisfied with such procedure?

14 A Well, I was an amateur. I never had any spe-
15 cial training or courses in finances nor any courses in
16 business or business administration or accounting or
17 auditing or balance sheets. That was all Greek to me and
18 they would bother me during the day. I am busy at the
19 office and they would call and interrupt and as my prac-
20 tice grew and I could put more money into my investment
21 program, their calls increased. They called me more and
22 more and finally around 1962, I had accumulated about
23 \$400,000 and at that point I just felt I wasn't capable
24 of managing that kind of money and that represented
25 security for myself and my family. If I died or got a



rk:mg

Rolf - direct

JA 83 24

THE COURT: Can you fix the month of that meeting?

THE WITNESS: I think it was in September of 1963.

A I met Mr. Sterling in his office and I told Mr. Sterling that I was interested in security in my capital, that I have reached a stage in life where I was very worried about keeping this capital, this \$400,000, because this was security for myself and my family, and Mr. Sterling said I didn't have to worry, he managed many large accounts and that he tried to stick to companies that were large, well-known firms, with solid earnings records.

He said he managed the Presbyterian Church Fund, that is a very large fund, and that impressed me. I felt if he managed the Presbyterian Church Fund, he must be a very conservative manager, and he said those were his objectives in managing an account.

Q Thereafter, you retained Mr. Sterling as your investment adviser, is that correct?

A Yes.

Q How long did Mr. Sterling serve as your investment adviser?

A Six years.

* * *

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2

Q Do you recall what Mr. Stott said to you?

3

MR. KELLY: Can I have the date on this, please?

4

Q Do you recall approximately when that telephone call occurred?

5

6

A That was the spring of 1969.

7

Q Do you recall in substance what Mr. Stott told you?

8

9

A Yes.

10

Q Would you state what he told you?

11

MR. KELLY: Again I would ask if we could get this identified. I realize the spring of 1969 is some identification. If the witness could do no better, so be it.

14

15

THE COURT: See if it is possible.

16

Q Do you know the exact date when that call was made?

17

18

THE COURT: If you know the date, tell us. If you know the week or the month, tell us.

19

20

THE WITNESS: I don't remember the date or the month. It was in the spring. I think it was maybe April.

21

22

Q Would you give us the substance of that conversation, Doctor?

23

24

A Mr. Stott called me and he said Mr. Sterling died and that the account had been assigned to him, and

25

1 he would like to manage it, and he said he had worked in
2 Mr. Sterling's office and he was very familiar with Mr.
3 Sterling's investment philosophy, and he said, as a matter
4 of fact, "I am familiar with your account, I used to see
5 it," and he said, "I am the biggest producer at Eastman
6 Dillon. I have had twelve years' experience and I manage
7 a lot of large accounts, and I am able in the securities
8 field."

9
10 Q Did you have any reservations about Mr. Stott's
11 capability to manage your account?

12 A Yes.

13 Q What was the nature of such reservation or
14 reservations?

15 A Well, I thought Stott was a capable person. He
16 was certainly mature, he had experience, but I realized
17 he was not an analyst and I didn't think he could generate
18 concepts or timing, what to do, when to buy and sell, like
19 Mr. Sterling did, so I said to him, "All right, but I
20 would like to have you secure the services of an analyst,
21 maybe a partner in Eastman Dillon, somebody outside of
22 Eastman Dillon," and he said he would try to find one for
23 me.

24 Q Did you have a plan or program at that time for
25 Mr. Stott as to an investment adviser?

1 rk:mg

Rolf- direct

2 MR. KELLY: I object to that question.

3 THE COURT: Sustained.

4 Q Did you express your reservation to Mr. Stott?

5 A Yes.

6 Q What did you say to him?

7 A I said, "I would like to have an investment ad-
8 viser in this working with you, then we could accomplish
9 a strong type of program."

10 Q Did you tell Mr. Stott that you would recommend
11 an investment adviser to work with him?

12 A No.

13 Q Did you ask Mr. Stott for a recommendation as
14 to an investment adviser?

15 A Yes.

16 Q Did Mr. Stott make such a recommendation?

17 A Yes.

18 Q Whom did Mr. Stott select?

19 MR. KELLY: Select?

20 Q Who did he recommend to you?

21 A Two people, Mr. Donald Geddes of Inverness
22 Management and Mr. Akiyoshi Yamada.

23 Q Did Mr. Stott tell you anything about Mr. Geddes
24 and Mr. Yamada at the time he made these recommendations?

25 A Yes, sir.

1 rk:mg
2 Q What did he tell you about Mr. Geddes?

3 A He said Mr. Geddes managed some rather extensive
4 accounts and he was an able investment manager, and that
5 he thought he could do an effective job.

6 Q What did he tell you about Mr. Yamada?

7 A Well, he said Mr. Yamada had established a very
8 good record at two companies he had been employed at be-
9 fore, that he was a very brilliant man, that he established
10 a very good record at these companies, that he came from
11 a very illustrious family in Japan, and his father is a
12 very wealthy man there, and he graduated from the Harvard
13 Business School, and he said he thought he could generate
14 some very good concepts.

15 Q Did you form the impression that Mr. Stott pre-
16 ferred one of these investment advisers over the other?

17 MR. KELLY: Objection.

18 THE COURT: Sustained.

19 Q Did you meet with Mr. Yamada?

20 A Yes.

21 Q Prior to retaining him?

22 A Yes.

23 Q Do you recall approximately when you met with
24 Mr. Yamada?

25 A I would think it was in April of 1969.

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rk:mg

Rolf-direct

JA 88 30

Q Would you state the substance of the conversation that took place at that meeting between yourself and Mr. Yamada in April 1969?

THE COURT: Where did this take place?

THE WITNESS: In a restaurant in New York.

A Mr. Yamada gave me his background and he said he was managing some rather extensive amounts of money. He managed several hedge funds and accounts of some very wealthy individuals and I said, "At this stage of life, I want to be sure of my equity, I have to protect it," and he said, "Don't worry, no client of mine has ever lost a penny." And I said, "I would like also to have same capital growth," and he said, "Look at my record at these other companies, I have a very good record. I was in charge of part of their research division," and he said, "You have nothing to worry about, I could do this," so forth and so on.

MR. KELLY: I would like to strike out the "so forth and so on."

THE COURT: Strike it.

Q Did you have any reservation about Mr. Yamada's capability?

MR. TESSLER: Objection, your Honor, unless that was expressed.

1
2 THE COURT: Sustained.

3 MR. SILVERMAN: If your Honor please, this is an
4 important question and I believe I can inquire into the
5 state of this witness' mind and it is important to our case,
6 and I do believe I am allowed to ask about state of mind of
7 the witness, and all that question seeks is the state of
8 this witness' mind, whether he had any mental reservations.

9 Perhaps if I reframe it and state it that way.

10 THE COURT Let's see how that comes out.

11 Q Did you form any impression as to the capability
12 of Mr. Yamada to manage your account?

13 A Yes.

14 Q What was that impression?

15 A Well, I thought Mr. Yamada was very brilliant
16 and capable and probably had as good a record as he talked
17 about, but I asked him, "How old are you?" And he said,
18 "26 years of age." And I thought, "Gee whiz, if he is 26
19 years of age, he may be brilliant, but he certainly could
20 not have had a great deal of experience, maturity, and
21 certainly I was looking for another Mr. Sterling, and I
22 felt, at 26, I didn't think he was another Mr. Sterling.

23 Q Did you conceive of any way to compensate for
24 Mr. Yamada's believed lack of experience?

25 MR. KELLY: Objection.

1 THE COURT: Sustained.

2
3 Q Did you retain Mr. Yamada notwithstanding the
4 fact that you believed he lacked experience?

5 A Yes.

6 Q What was your reason for doing so?

7 MR. KELLY: I will object to the reasons for
8 doing so. If this case is going to be tried on the basis
9 of the mental attitude, the impression, or viewpoints of
10 the witness, uncommunicated to others, I don't feel we
11 are going to come up with evidence in this kind of 10B
12 case which involves fraud.

13 THE COURT: Counselor, to the best of my recol-
14 lection, each time there has been an objection on the
15 point, it has been sustained.

16 MR. SILVERMAN: is your Honor sustaining that
17 objection?

18 THE COURT: State the question again.

19 MR. SILVERMAN: May I ask that the reporter read
20 it.

21 (Record read)

22 THE COURT: Sustained.

23 Q Earlier you said that you had some reservations
24 about Mr. Stott because he wasn't an investment adviser.

25 Did you communicate your reservation to Mr. Stott?

1
2 A Yes.

3 Q What did you say to him?

4 A I said, "I would like to have the services of
5 an investment adviser to work with you who has some ex-
6 perience as an analyst."

7 Q Now, you have testified you have had certain
8 reservations about Mr. Yamada based upon his youth. Did
9 you communicate such reservation to Mr. Yamada?

10 A I told Mr. Yamada I would like to have him work
11 with Mr. Stott.

12 Q What was your reason for telling Mr. Yamada that
13 you would like to have him work with Mr. Stott?

14 MR. KELLY: Objection.

15 THE COURT: Sustained.

16 Q Did you tell Mr. Yamada your reason for wanting
17 him to work with Mr. Stott?

18 A I told Mr. Yamada to have all the securities
19 go through Eastman Dillon and I said it was a large broker-
20 age house, I felt comfortable there, and I said Mr. Stott
21 could watch this and the two of you can work together,
22 and we will have a good arrangement.

23 Q After you determined to retain Mr. Yamada, did
24 you communicate that fact to Mr. Stott?

25 A Yes.

Q What did you tell Mr. Stott?

MR. KELLY: Can I hear when, your Honor?

THE COURT: Fix a time.

Q Can you tell us approximately when in relation to your meeting with Mr. Yamada that you communicated to Mr. Stott that you had retained Mr. Yamada?

A I can't give you the exact date, but it was soon afterward.

Q What did you tell Mr. Stott?

A I told Mr. Stott that I would have this meeting with Mr. Yamada and I told him that I would inform Mr. Yamada that all the securities were to go through Eastman Dillon, and I said, "Mike, I can take this account any place. I am going to leave this account here," but I said, "Look, I want you to watch this. After all, you are going to be compensated from this, you are going to get all the commission business, and when I am back in Cleveland and busy, you keep your eye on things."

Q What did Mr. Stott say?

A That was agreeable to him.

Q What did you hope to accomplish by allying Mr. Yamada with Mr. Stott?

MR. KELLY: Objection.

THE COURT: I will take it, but only as evidence

rk:mg

Rolf-direct

JA 93 35

of his state of mind.

Q Do you recall the question?

A Yes.

Well, I had told Stott that I want to have a Sterling type of operation. I was very happy with Mr. Sterling and if we could continue that way, it would be great, and I thought perhaps a young man as bright as Yamada, he could generate investment ideas and tell us what to do and with Mike Stott, with his experience behind him, kind of watching and supervising this thing, and I also thought at Eastman Dillon, Mr. Sterling told me they had one of the best research departments in the country, and I thought that would be a backup.

I felt maybe we could have a Sterling-type operation.

Q So far you have told us what you said orally. Did you commit, Dr. Rolf, any of these concepts or ideas that you had or that you told Mr. Stott about working together with Mr. Yamada to writing?

A Yes.

Q I show you what has been marked as Plaintiff's Exhibit 1 for identification, and I ask you, Dr. Rolf, if that is a facsimile of your signature that appears on the bottom.

* * * *

1
2 attention?

3 The second page, the top paragraph?

4 THE WITNESS: Yes.

5 A In the next paragraph: "He has informed me
6 many times that no client of his has ever lost money."

7 Q You have testified that you sent a copy of Plain-
8 tiff's Exhibit 3 to Mr. Stott.

9 What was your reason for doing so?

10 A That was one of the occasions when Mr. Yamada
11 had many schemes that he proposed to me, as he claims,
12 to restore my equity, and this is one of them. I thought
13 that Stott should know about it, so maybe he can get
14 Yamada to do this, so they could get this thing worked
15 out for me.

16 THE COURT: We will interrupt here and take a
17 ten-minute recess.

18 (Recess)

19 THE COURT: It is apparent from the list of
20 exhibits which plaintiff has marked for identification
21 that there are going to be many documents received, and
22 if we continue as we proceeded this morning, there are
23 apt to be many questions which address the witness' state
24 of mind.

25 I am aware what the witness considers to have



1 rk:mg

Rolf-cross

JA 95 65

2 CROSS-EXAMINATION

3 BY MR. KELLY:

4 Q Doctor, with regard to the note that you re-
5 ceived from Mr. Yamada, to which you recently referred,
6 do you have that note?

7 A Do I have it with me?

8 Q Do you know where it is? Is it in the pos-
9 session of your counsel?

10 A I think it is.

11 MR. KELLY: I will ask for the production of
12 that note following the recess, Mr. Silverman, unless you
13 have it now.

14 MR. SILVERMAN: Your Honor, I certainly don't
15 have the note with me. I will look in my office and I
16 probably won't get it for you before the recess, but if
17 I find it, I shall certainly turn it over to you.

18 THE COURT: That is the promissory note?

19 MR. KELLY: I don't know what it is. It is a
20 note.

21 THE COURT: That is what the witness has de-
22 scribed as a promissory note or a guarantee.

23 Q I take it that note was signed by Mr. Yamada?

24 A Yes.

25 Q Doctor, I want to ask you about Delanair, Inc.



1 lz ja 5

Rolf - cross

2 Eastman, Dillon to pay for those securities out of your
3 account, had you any discussion about Delanair with
4 Mr. Stott?

5 A Yes.

6 Q When did those discussions take place?

7 A In that period when Mr. Yamada recommended
8 Delanair, and he said -- he indicated the investment
9 would be about \$400,000, and I thought that was quite a
10 bit of money, so I called Mr. Stott, and I said, "Mike,
11 what is this? This is a lot of money for me in this one
12 security."

13 And Mike said, "Well, I think if Yamada said it
14 was all right, it's all right. You can go ahead with it."

15 Q Did Mr. Stott tell you that he had any knowledge
16 of the operations of Delanair?

17 A No.

18 Q Did he tell you that he had any knowledge of
19 the prospects of Delanair?

20 A No.

21 Q Did he tell you anything about the business or
22 the management of Delanair?

23 A No.

24 Q Did he make any statement to you whatever with
25 regard to the worth or value of the security?

1 lz ja 14

Rolf - cross

JA 97

2 I thought it was being managed by Mr. Sterling.

3 Q With respect to the securities in the account
4 on April 27, 1969, what security reflects in your judgment
5 any mismanagement or failure on the part of Mr. Sterling?

6 A Well, I can't point to any security. I am not
7 expert. But the account depreciated in value considerably
8 during that period, and I'm sure that if Mr. Sterling were
9 managing it, that wouldn't have happened.

10 Q You mean there was no time in which Mr. Sterling
11 ever purchased a security that thereafter declined in value?

12 A Oh, yes.

13 Q Which securities here do you suggest reflect
14 the depreciation that you referred to?

15 A I can't point to any specific security, but my
16 equity position decreased markedly during that period and
17 I was under the impression Mr. Sterling was managing it.

18 Evidently he was sick and nobody was managing
19 it. Evidently he had a malignant brain tumor.

20 Q Do you have any objection to Asamera?

21 A I don't know. I am not an expert. If
22 Mr. Sterling bought it, it was all right with me.

23 Q Have you any -- you -- with respect to these
24 securities that were held in your account on this date --
25 where Mr. Sterling did something wrong or failed to do

1 iz ja 15

Rolf - cross

JA 98

2 something he should have done?

3 A I don't know what he should have done. All I
4 know is that the account decreased in value tremendously
5 and that never happened when Mr. Sterling managed the
6 account, not like that.

7 Q Are you suggesting that that account decreased
8 in value or depreciated by reason of the sales that were
9 later made of these securities?

10 A I can't explain it. I don't know why it
11 depreciated. All I know is, had Mr. Sterling handled this
12 account, I don't know what he would have done, but I am
13 reasonably sure on his past record over the past six years
14 we would not have had this kind of situation.

15 Q What you are saying is he should have sold some
16 of these securities; is that correct?

17 A I don't know what he should have done. He
18 was the one that was managing the account. It wasn't me.

19 Q Do you have any personal knowledge as to when
20 Mr. Sterling became ill?

21 A I think he became ill in the fall of 1968.

22 Q What part of the fall?

23 A I think late in the fall. I'm not sure.

24 Q Do you know of your own personal knowledge of
25 the nature of his illness?

1 lz ja 21

Rolf - cross

JA 99

2 MR. SILVERMAN: I will further stipulate any-
3 thing he said here is true and he stands by it.

4 THE COURT: Any objection?

5 MR. TESSEL: I certainly have not seen any
6 of those depositions. Mr. Yamada was not present --

7 THE COURT: I will accept that. We can't
8 do it until counsel on behalf of Mr. Yamada has had a
9 chance to go over the deposition so we will have to take
10 it in this fashion.

11 MR. KELLY: Let me eliminate this, your
12 Honor, in the interest of abbreviation.

13 BY MR. KELLY:

14 Q Did you hear your counsel this morning say that
15 Mr. Herb Sterling handled the account in "an exemplary
16 fashion"?

17 A Yes.

18 Q Do you agree with the correctness of that
19 characterization?

20 A Yes.

21 Q Do you recall your counsel saying this morning
22 that in every respect the activities of Mr. Sterling in
23 handling your account had furthered your investment
24 objectives?

25 A Yes.

1z ja 22

Rolf - cross

JA 100

Q Do you agree with the correctness of that
characterization?

A Yes.

Q Am I correct in stating that you instructed
Mr. STerling while he was managing your account that your
investment objective was to double your equity?

A I didn't instruct him to double my equity.

Q I can't hear you.

A I did not instruct him to double my equity.

Q I didn't ask you that. I asked you whether
you told Mr. Sterling that that was your investment
objection.

A No.

Q You did not?

THE COURT: Speak more loudly, Doctor.

Q I will show you Defendant's Exhibit C. Is
that your letter?

THE COURT: Is that your letter, sir?

THE WITNESS: Yes.

MR. KELLY: I will offer it in evidence.

THE COURT: Any objection?

MR. SILVERMAN: None, your Honor.

THE COURT: Exhibit C is received.

(Defendant's Exhibit C for identification was

* * *

* * * *

1 lz ja 25

Rolf - cross

JA 101

2 outside adviser or a partner on Sterling's level.

3 "Q Was this the sequence on which the conversation
4 went as best you can recall?

5 "A That is the context.

6 "Q And you said you wanted either someone on
7 Sterling's level or an investment advisor?

8 "A Of Sterling's caliber.

9 "Q Of Sterling's caliber or an investment adviser?

10 "A Of Sterling's caliber.

11 "Q Is that what you stated, you wanted an investment
12 adviser of Sterling's caliber?

13 "A Of Sterling's caliber. I said find me another
14 Sterling."

15 Did you so testify?

16 A Yes.

17 Q And is that testimony correct?

18 A Yes.

19 Q Am I correct in saying that you did not want
20 Mr. Stott to handle your account?

21 A I didn't say I didn't want Mr. Stott to handle
22 the account. I wanted to have an analysis of Sterling's
23 caliber.

24 Q My question is, am I correct in saying that you
25 did not want Mr. Stott to handle your account?

1 12 ja 26

Rolf - cross

JA 102

2 A At that time?

3 Q At that time.

4 A Yes, at that time I wanted someb ody of Sterling'
5 caliber.

6 Q And that was not Mr. Stott?

7 A That was not Mr. Stott.

8 Q You wanted somebody other than Mr. Stott to
9 do for you what Mr. Sterling had been doing before?

10 A Yes.

11 Q Did you at that time discuss with anyone other
12 than Mr. Stott the selection of a person to advise you on
13 investments?

14 A No, not that I recall.

15 Q When did you for the first time meet Mr. Stott
16 face to face?

17 A That was much later.

18 Q Would October 1970 be about right?

19 A I think so.

20 Q Let me show you, Doctor, Exhibit 4, the first
21 sentence of a letter to Mr. Stott.22 Would that confirm that you first met him in
23 October 1970?

24 A Yes.

25 Q That was a meeting at the bar of the Waldorf?

2 A Yes.

3 Q That was the meeting that lasted a few minutes?

4 A It didn't last very long.

5 Q Is a few minutes a fair statement?

6 A Yes.

7 Q After your discussions with Mr. Stott, did he
8 then recommend to you Akiyoshi Yamada, who had been with
9 Kuhn Loeb and First National City Bank, and Don Geddes,
10 who had been with Inverness Management Corporation?

11 A Well, this is in October 1970 --

12 Q No, I mean after you conversation with Mr.
13 Stott, when you told him what you told him about his
14 request to handle your account, then did he make these
15 recommendations of these two people?

16 A Yes.

17 Q With respect to the discussions you had
18 with Mr. Stott on his recommendation of Mr. Yamada, I would
19 like to read from your testimony given at your deposition
20 and ask if you do so testify and if it's right.

21 I will commence at page 123, line 10.

22 Are you ready, Doctor?

23 A Yes.

24 Q "Q Did he say anything about Mr. Yamada?

25 "A He said that Mr. Yamada had a good record at

1 lz ja 28

Rolf -cross

JA 104

2 Kuhn, Loeb and National City Bank.

3 "Q First National City Bank?

4 "A Whatever it is, the Bank of New York.

5 "Q And did he expand upon that at all?

6 "A That was the essence of it.

7 "Q That he had a good record?

8 "A Yes.

9 "Q What did you understand a good record to mean?

10 "A That he could manage money effectively.

11 "Q Did Mr. Stott say anything else about Mr.

12 Yamada in that conversation?

13 "A That was the essence.

14 "Q To the best of your recollection he said nothing
15 else about Mr. Hamada?16 "A Well, that was the important thing. I don't
17 know what else he said, but this sticks in my mind, these
18 two things.19 "Q You do not recall that he said anything else;
20 is that correct?

21 "A Nothing of importance."

22 Did you so testify?

23 MR. SILVERMAN: Wait, I think he should finish
24 because there is more.

25 MR. KELLY: Read it in later.

1z ja 29

Rolf - cross

JA 105

MR. SILVERMAN: I think I am entitled --

THE COURT: Yes, you are. If it's brief,
you may read it.

MR. SILVERMAN: Do you want me to read it, your
Honor, or ask Mr. Kelly to read it?

MR. KELLY: I will read it.

Just tell me which questions and answers you
want me to read.

Q "Q Did he say anything that was not of
importance but which was about Mr. Yamada in that conversa-
tion?

"MR. SILVERMAN: Do you recall anything about
the conversation other than what you have testified?

"THE WITNESS: That he was a young man.

"Q Mr. Yamada?

"A Yes. That his family was prominent in Japan
and came from a prominent family in Japan. That he was very
wealthy. That was it, you know.

"Q Did he indicate how long Mr. Yamada had been
in the money-managing or brokerage business?

"A The impression I had was that he had not been
in it very long, five years, six years, something like
that, four years.

"Q Did Mr. Stott say anything to give you that

1 lz ja 30

Rolf - cross

JA 106

2 impression?

3 "A I had that impression. I think those were his
4 exact words.

5 "Q Did Mr. Stott say anything else about Mr.
6 Yamada that you can recall in that conversation?

7 "A That he knew him very well, that they were
8 personal friends, that they had lunch together frequently,
9 that his wife entertained Yamada's wife, whatever it was.
10 Anything else -- that's about all."

11 Is that what you testified at the deposition?

12 A Yes.

13 Q Is that testimony complete, a complete
14 description of the significant substance of that conversation?

15 A As best I recall.

16 Q Following this talk with Mr. Stott, did you
17 check out Yamada by calling Kuhn, Loeb?

18 A Are you directing that question to me?

19 Q Yes.

20 A Yes.

21 Q Tell me -- did you talk to an officer at Kuhn,
22 Loeb?

23 A I don't know if it was an offer or not, but
24 I talked to somebody at Kuhn, Loeb who worked with
25 Mr. Yamada.



1 lz ja 8

Rolf - cross

JA 107

2 a statement reflecting the sale of those securities?

3 A Yes.

4 Q With respect to the sale, let's say, of INA,
5 did you express objection to Mr. Yamada that he should
6 not have made that sale at or about that time?

7 A No.

8 MR. TESSLER: Your Honor, I don't mean to be
9 technical, but there has been no evidence here other than
10 Mr. Kelly's statement that the sale was made by Mr. Yamada.

11 THE COURT: That is so.

12 Sustained. Strike it.

13 MR. KELLY: Your Honor, could I have the
14 question read back?

15 THE COURT: Read it back.

16 (Question read)

17 Q With respect to INA, when you received the
18 confirmation, did you express objection to Mr. Yamada to
19 the fact that a sale was made?

20 A No.

21 Q With respect to Penn Central, did you express
22 to Mr. Yamada an objection to the fact that Penn Central
23 was sold?

24 Q No.

25 Q If I asked you the same questions with respect

1 lz ja 53

Rolf - cross

JA 108

2 to Anaconda, Asamera, Avnet and CNA Financial, would your
3 answer be the same?

4 A Yes.

5 Q Did you at the time you received those
6 confirmations made any -- take any -- tell Mr. Stott that
7 the sale should not have been made?

8 A I complained to Mr. Stott -- I didn't complain
9 to Mr. Stott about the sales per se.

10 Q I am talking only about these securities.

11 MR. SILVERMAN: If your Honor please, can the
12 witness answer the question?

13 THE COURT: He is just clarifying the question.
14 He is trying to answer. Let's float easily, gentlemen.
15 We will be here a while one way or the other. Let's try
16 to just move with some ease and grace through this.

17 Go ahead, sir.

18 You say that you didn't speak to Mr. Stott about
19 these specific stocks as such?

20 THE WITNESS: Yes.

21 THE COURT: What was the rest of your answer?

22 THE WITNESS: I complained to Mr. Stott about
23 all of these securities that I was somewhat familiar with
24 being sold. I mean the whole group.

25 Q When did you say that?

1 lz ja 54

Rolf - cross

JA 109

2 A Soon after these were sold and they bought, you
3 know, all these other stocks that I mentioned.

4 Q In other words, you are saying that you took
5 objection with Mr. Stott when you saw what was being bought
6 with the proceeds of these?

7 A Yes.

8 Q But you did not speak to him about the sale
9 of these itself?

10 A Yes.

11 Q It was not the sale you objected to, it was
12 what you were being put into?

13 A Yes.

14 Q Do you know of your own knowledge, Doctor, with
15 respect to these securities I mentioned to you, Anaconda,
16 Asamera, Avnet, CNA Financial, Penn Central, and INA; do
17 you know who made and directed the sale of those securities?

18 A I presume that --

19 MR. TESSLER: I object to any presumption.

20 THE COURT: Sustained.

21 A I think that Mr. Yamada directed the sale of
22 these securities.

23 MR. SILVERMAN: Testify to your knowledge.

24 MR. KELLY: Is that an objection?

25 THE COURT: I will consider it an objection.

1z ja 55

Rolf - cross

JA 110

1 The question is quite specific. Do you know
2 who directed the sale of those stocks?
3

4 THE WITNESS: Mr. Yamada.

5 MR. TESSEL: Your Honor, I thought the witness
6 said he presumed it was Mr. Yamada.

7 THE COURT: He did, and I struck that. I put
8 the question quite specifically, and he answered it quite
9 clearly.

10 BY MR. KELLY:

11 Q Doctor, I am going to go through three more,
12 but this time I am going to say, were they not sold in June
13 of 1969.

14 Loew's warrants, Leasco warrants, and National
15 General; were they not sold in June?

16 Loew's warrants, Doctor?

17 A Yes.

18 Q Leasco warrants.

19 A Yes.

20 Q And National General?

21 A Yes.

22 Q And in July, Doctor, I will ask you, were not
23 the following sold: Leeson Corporation?

24 A Yes.

25 Q Levin Townsend?

1 lz ja 56

Rolf - cross

JA 111

2 A Yes.

3 Q Scientific Resources?

4 A Yes.

5 Q And prior to the acquisition of other holdings
6 in this account, I take it that you did not express objection
7 to Mr. Yamada or to Mr. Stott saying these securities
8 should not have been sold?

9 A I don't object -- I didn't have any opinion on
10 whether they should or shouldn't be sold. I can't tell
11 you whether the stock should or shouldn't be sold. I
12 objected to good securities being sold and the money being
13 put in these obsolete securities -- I'm sorry, in these
14 obscure securities.

15 THE COURT: We will take a little break.

16 (Recess taken)

17 THE COURT: We will proceed until four-thirty.

18 Q Dr. Rolf, after May 9, 1969, when you authorized
19 Yamada to trade in your account at Eastman, Dillon, did
20 you open brokerage accounts with other broker-dealers in
21 your name?

22 A Yes.

23 Q Doctor, I am going to show you Defendant's
24 Exhibit S, S-1 and S-2, which have not been offered in
25 evidence, and preliminarily, Doctor, I will ask you, did you



rkbr 1

David E. Rolf

v

Blyth Eastman Dillon Co., etc.

New York, New York

June 24, 1976

10:30 a.m.

- - -

(Trial resumed.)

- - -

MR. SILVERMAN: Your Honor, through agreement with defendants' counsel, they have agreed to permit Mr. Whitman to testify now on direct and cross and to interrupt the cross of the plaintiff David Rolf.

The plaintiff calls Martin J. Whitman.

M A R T I N J. W H I T M A N, called as a witness on behalf of the plaintiff, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. SILVERMAN:

Q What is your present occupation, Mr. Whitman?

A I am president and chief executive officer of M.J. Whitman & Company, Inc., members of the National

rkbr 2

Whitman-direct

JA 113

Association of Securities Dealers.

Q What is the business of M.J. Whitman & Co., Inc.?

A The company is a broker-dealer.

Q For how many years have you been engaged in the securities business?

A Approximately 25.

Q Would you trace for us your career in the securities business?

A The end of 1950 I was employed by Shearson Hammill & Company as a trainee in their research department. I remained with Shearson Hammill as an analyst for approximately five years, at which time I transferred to Shearson Hammill's buying department where I was engaged in underwriting activities.

After leaving Shearson Hammill in 1956, I spent several years on the staff of William Rosenwald, the personal staff of Mr. Rosenwald, Mr. Rosenwald being a wealthy private investor who among other entities controlled American Securities Corporation, an NASD member.

I then became head of research of Ladenburg Thalmann. That was 1958, where my activities included not only research, I handled customers and was engaged in certain corporate finance activities.

rkbr 3

Whitman-direct

JA 114

1
2 In 1960 I moved to Philadelphia and became
3 a general partner of Gerztley, Sunstein & Company, members
4 of the New York Stock Exchange where my duties again
5 included being head of research, corporate activities.

6 In 1967, I returned to New York City joining
7 Blair & Company as a vice president and director. At
8 Blair my activities besides handling customers accounts were
9 involved solely with corporate finance activities.

10 At the end of 1968 I went out on my own, I was
11 for a while a registered representative, and formalized,
12 my activities in 1974 into a corporation which is now
13 M.J. Whitman & Co., Inc.

14 Q Mr. Whiteman, are you on the staff of any
15 university?

16 A Yes. For the last four years I have held a
17 position of lecturer at Yale University where I conduct
18 a weekly investment seminar entitled "Money and Financial
19 Institutions".

20 Q Mr. Whitman, have you been the author of any
21 articles or books pertaining to the matters in the
22 securities industry?

23 A Yes; I have authorized numerous articles, titles
24 including Mergers and Acquisitions, Corporate Realty and
25 Accounting for Investors, the Strategy of Tender Solici-

1 rkbr 4

Whitman-direct

JA 115

2 tations.

3 I am the author in collaboration with Professor
4 Martin Shubert of Yale of a book entitled Investment
5 Myths and Realities, which is to be published some time
6 in the next several months by Basic Books, a Division of
7 Harper & Rowe.

8 Q Mr. Whitman, have you been called upon by any
9 government agency at any time to serve as a consultant?

10 A Yes. I was a consultant to the Securities and
11 Exchange Commission in connection with their so-called
12 Wheat Report, the disclosure study which issued I think in
13 1969. I have been called upon to testify before the
14 Senate Antitrust Monopolies Subcommittee about securities
15 matters.

16 Q Mr. Whitman, on any prior occasion have you been
17 qualified to give expert opinion evidence in a litigation
18 involving the Securities Acts?

19 A Yes.

20 Q How many such actions over the past ten years?

21 A I would estimate about 35, maybe 40 times.

22 Q Would you identify some of those actions and the
23 attorneys who called you as their expert?

24 A Well, you called me twice, Reader v. Mastercraft
25 and Feit v. Leasco. In the Eastern District I have been

1 rkbr 5 Whitman-direct . JA 116

2 called upon by Shea, Gould, Climenko Company. I have been
3 called upon by Young, Conoway & Taylor to represent Mac Don
4 & Company. I am currently involved with Reavis & McGrath
5 in connection with a matter involving American Medicorp
6 entitled State of California v. American Medicorp;
7 Harold Cohen PA in a matter Cohen v. American Metal
8 Climax; Emanuel Becker in a matter entitled Gerstal v.
9 Gamble Skogmo. There have been quite a number of others.

10 MR. SILVERMAN: I ask to have marked for
11 identification, a two-page document headed Qualifications
12 and purporting to be the curriculum vitae of Martin J.
13 Whitman. I ask it be marked Plaintiff's Exhibit 11 for
14 identification.

xx 15 (Plaintiff's Exhibit 11 was marked for
16 identification.)

17 MR. TESSLER: Your Honor, it was marked for
18 identification.

19 MR SILVERMAN: Yes.

20 Q I show you what has been marked for
21 identification as Plaintiff's Exhibit 11 and I ask you
22 if Plaintiff's Exhibit 11 reflects your qualifications
23 and your curriculum vitae.

24 A Yes, it does.

25 MR. SILVERMAN: I offer Plaintiff's Exhibit 11

1 rkbr 6 Whitman-direct

JA 117

2 in evidence.

3 MR. KELLY: No objection.

4 MR. TESSLER: Objection, your Honor. I think
5 the qualifications of this witness have been testified to on
6 the stand. I don't see what the submission of those
7 qualifications in written form add to this case. Based
8 upon testimony given, it will be up to the Court to determine
9 whether he is so qualified to testify in this case.

10 THE COURT: I will receive it. It will aid
11 the Court.

xx 12 (Plaintiff's Exhibit 11 was received in
13 evidence.)

14 Q Mr. Whitman, at my request did you review the
15 purchases of securities made in Dr. Rolf's account during
16 the period May 1, 1969 through March 31, 1971?

17 A Yes, I did.

18 THE COURT: Do you plan to make a formal
19 application to have Mr. Whitman declared by the Court to
20 be an expert in some fashion in connection with this case?

21 MR. SILVERMAN: Yes, your Honor. I had
22 intended that that would arise when I asked for his opinion
23 if anybody objected but I am prepared to do so now..

24 THE COURT: In whatever sequence you would like.
25

1 rkbr 7

Whiteman-direct

JA 118

2 BY MR. SILVERMAN:

3 Q In the course of your review of such purchases,
4 did you make any effort to grade the securities purchased?

5 A Yes, I attempted to grade the quality of the
6 issues.

7 Q What classifications did you use in grading the
8 securities purchased during that period?

9 A I used five classifications. The first being
10 high or reasonable quality issues. The second being
11 low quality issues, the third being lowest of the low
12 quality issues and then there were interspersed two
13 borderline categories between reasonable quality and low
14 quality and between low quality and lows of the low
15 quality.

16 Q In making your classifications, did you use
17 subjective or objective standards?

18 MR. TESSLER: Objection. Calls for a con-
19 clusion of the witness on a definition of terms that has
20 not been made here.

21 THE COURT: Why don't you just reframe the
22 question.

23 MR. SILVERMAN: Surely, y our Honor.

24 Q What standards did you use in making your
25 classifications?

rkbr 8

Whitman-direct

JA 119

1 A I attempted to use standards that were readily
2 determinable. They went to size of the company, seasoning
3 of the company and the issue in question, dividend record
4 as pertains to the issue, earnings record as pertains to the
5 issue, market information as pertains to the issue, that
6 is, the marketability of the issue, and availability of
7 disclosure to outside passive investors who might have an
8 interest in the security.

9 Q What was the relevance in your opinion of
10 using size as one of the standards in making your classifi-
11 cations?
12

13 A As a general rule, a portfolio consisting of
14 issues of larger sized issuers who tend to be a better
15 quality portfolio than a portfolio consisting largely of or in
16 part, of very small companies.

17 MR. TESSLER: I move that answer be stricken
18 as it is strictly a conclusion of the witness. I have no
19 idea what better quality portfolio means.

20 THE COURT: Overruled.

21 Q What are the components of size as you use
22 that term as one of your standards?

23 A In order to make up the table, I used three
24 measures of size; sales, total assets, net profits.

25 Q The second standard that you mentioned was

rkbr 9

Whitman-direct

JA 120

seasoning of the company; is that correct?

A Yes.

Q What did you mean by seasoning of the company?

A How long the company has been in business.

Q How is such a standard relevant in classifying securities by quality?

A The longer a business entity has been in existence, the better quality it tends to be, or rather, I would say more specifically, in a portfolio, the more companies that are represented by issues of companies that have been in existence for a long time, the better quality that portfolio is likely to be.

Q Your third standard I believe was dividend record. How was that relevant in your classification?

A I am sorry, Mr. Silverman. I think my third standard was seasoning of the issue.

Q You are right, seasoning of the issue.

Would you tell us first what you mean by seasoning of the issue?

A That means how long the issue or any issue of the issuer has been publicly traded. Again on the same theory that the longer an issue has been available for trading, the better quality that issue is likely to be insofar as it is part of a portfolio. A portfolio consisting of issues

1 rkbr 10

Whitman-direct

JA 121

2 which have been traded for a long time is likely to be
3 a better quality portfolio.

4 Q What is your reason for believing that secur-
5 ities that have been traded for a long period of time
6 are likely to be of better quality than securities that
7 are newly traded?

8 A Seasoned issues tend to be correlated back to
9 seasoned issuers and when a company has been on the market
10 for a long time, it tends to get a better market, tends to
11 attract a more knowledgeable class of investor interest.

12 MR. TESSLER: Your Honor, I hesitate to stand
13 again to object but I must object to these characteri-
14 zations.

15 THE COURT: I will take it.

16 MR. TESSLER: Would Mr. Silverman concede what
17 he is getting now is the witness' opinion? It would
18 alleviate my making objections. These certainly aren't
19 objective facts that are being stated.

20 THE COURT: I had understood it to be the
21 witness' opinion. If you had intended otherwise, let me
22 know.

23 MR. SILVERMAN: No, your Honor, these are his
24 opinions as to why a particular standard is important.

25 MR. TESSLER: Thank you.

rkbr 11

Whitman-direct

JA 122

Q Am I correct in saying that the fourth standard is dividend record?

A Yes.

Q How is that significant in evaluating the quality of a security in your opinion, Mr. Whitman?

A In my opinion, a portfolio consisting of securities which pay dividends or interest, tends to be a higher quality portfolio even when issues in that portfolio do not afford the investor any cash return.

Q Your fifth standard was earnings record, is that correct?

A Yes.

Q What is the significance of earnings record in the classifications which you made?

A The specific earnings record I referred to in measuring quality was whether or not the company had a record of five years of continual profits. Portfolios consisting of issuers would have been profitable over a five-year period would tend to be a higher quality portfolio than one containing issues that do not meet that standard.

Q Your sixth standard was market information. What do you mean by market information?

A For a portfolio consisting of issues which are traded on organized exchanges, especially the

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Whitman-direct

JA 123

New York Stock Exchange, such issues would tend to be higher quality than a portfolio consisting of issues which are not traded on organized exchanges.

Where securities are actively traded, there would tend to be a quality consideration to have a portfolio consisting of actively traded securities rather than lockups. During the relevant period here, voluntary information was available only for securities listed on organized exchanges.

Q You used the phrase lockups. What does that phrase mean to you, Mr. Whitman?

A That means you own a security that you can't sell in an orderly market.

Q What would be the reasons for not being able to sell such a security in the ordinary market?

A The alienability factors such as legal restrictions and contractual restrictions on sale. There would be blockage factors such -- which would go to the ability of any individuals holdings could be absorbed by a market in an orderly fashion.

I guess you would summarize the thing under alienability and blockage.

Q Could there also be a situation where no market exists for the security?

1 rkbr 13

Whitman-direct

JA 124

2 A I include that in blockage.

3 Q Your final standard was availability of dis-
4 closure. What did you mean by that phrase?

5 A Well, for an outside passive investor, if he
6 does not have available to him disclosures about the secur-
7 ities in the portfolio, he is faced with having a low
8 quality portfolio, in contrast distinction the availability
9 of information about a security, about the issuer and about
10 the markets would tend to make a portfolio consisting
11 of those securities higher quality than would otherwise be the
12 case.

13 Q Based upon your review of Dr. Rolf's securities,
14 were you able to grade any securities purchased during
15 the period I had previously referred to and that is
16 May 1, 1969 to March 31, 1971?

17 MR. KELLY: I will object to that question
18 unless there is established the securities to which
19 reference is being made.

20 THE COURT: Well, this question can be
21 answered and we still have to get to your concern.

22 I think I will allow this question. He is
23 being asked generally whether he was able to make
24 certain adjustments and I think he can answer that.

25 MR. TESSLER: Would you hear my objection,

1 rkbr 14

Whitman-direct

JA 125

2 please?

3 THE COURT: Yes.

4 MR. TESSLER: If I understand Mr. Silverman's
5 prior testimony -- I am sorry, Mr. Whitman's prior testimony,
6 and in view of the colloquy that took place a few minutes
7 ago, I think all that this answer elicits is whether or
8 not in Mr. Whitman's opinion this is a good quality portfolio
9 and I would object to that because there has been no testi-
10 mony on direct or examination of Dr. Rolf or questioning
11 of Mr. Whitman that is criteria with the same as Dr. Rolf's
12 criteria.

13 THE COURT: You can bring that out in your
14 posttrial submissions. That is proper argument, but
15 I won't sustain an objection.

16 There is an outstanding question. I think
17 the question was, in effect, Mr. Whitman, whether you had
18 made any judgments with reference to Dr. Rolf's securities
19 which you were aware of with reference to the period which
20 has been described.

21 Is that the question?

22 Q Whether you were able to grade any of the
23 securities purchased during that period as being of the
24 lowest of the low.

25 A Yes.

1 rkbr 15

Whitman-direct

2 Q How many such securities in your opinion
3 fell into that category?

4 MR. KELLY: Your Honor, this may be a renewal
5 but it is a very important issue. It is an important
6 objection. It is going to pervade this testimony.

7 I do not know what purchases are being talked
8 about. I don't know whether they are purchases on
9 Schedule 2 or Schedule 6 or whether they are securities
10 that Dr. Rolf bought out in California or he bought from
11 Am Swiss --

12 THE COURT: Would you hold your point a minute?

13 MR. KELLY: I don't know what he is talking
14 about.

15 THE COURT: Read back the question.

16 (Read.)

17 THE COURT: I am going to take the answer.

18 I recognize you are entitled to have an answer to your
19 question but I don't think we have allowed Mr. Silverman
20 to get there yet.

21 A 15.

22 THE COURT: There is, however, an outstanding
23 problem. There has not yet been a request for the
24 witness to be declared an expert in a particular respect.
25 There is no ruling by the Court with respect to it and you

rkbr 16

Whitman-direct

are now asking for, I gather, his expert opinion.

MR. SILVERMAN: Yes, I am, your Honor, and perhaps I should now request that Mr. Whitman be permitted by the Court to give expert testimony as to what in his opinion the quality of the securities as purchased in Dr. Rolf's account during the relevant period were.

THE COURT: You asked he be qualified as an expert in what respects, more generally than to relate particularly to the stock?

MR. SILVERMAN: To give his view as a professional as to the quality --

THE COURT: No. The issue is not whether he should give his view. The issue is whether he was qualified based upon what has been elicited so far, presented so far in a particular respect in order to be declared an expert in that respect.

You frame the question.

Q Mr. Whitman, in your opinion --

THE COURT: The question, if I may suggest, and it is an application to be made to the Court, that is what I really meant.

MR. SILVERMAN: Your Honor, I hereby apply for leave to have Martin J. Whitman qualified as an expert to give opinion evidence as to the quality of the securities

rkbr 17

Whitman-direct

JA 128

1 purchased in Dr. Rolf's account based upon the standards
2 that he has enunciated in his prior answers to prior
3 questions.
4

5 THE COURT: I believe what you are asking,
6 Mr. Silverman, is that Mr. Whitman be found by the Court
7 to be qualified as an expert witness in connection --
8 I think you are asking that he be qualified as an expert
9 with respect to the quality or worth of securities in the
10 commercial market.

11 Would that be a general statement of your
12 request?

13 MR. SILVERMAN: Yes, your Honor, as a man who
14 has been in the securities industry for 25 years --

15 THE COURT: I don't need the qualifications,
16 I need the question.

17 MR. SILVERMAN: In research, can he give an
18 opinion as to the grade of the securities that were pur-
19 chased?

20 THE COURT: But you say that gets to Question 2.
21 Question 1 is the one we are after. You want him
22 qualified as to a particular degree of expertise in order to
23 get to this next question?

24 MR. SILVERMAN: Yes, Judge.

25 THE COURT: I think it is that he wishes him

rkbr 18

Whitman-direct

JA 129

qualified as an expert in terms of the worth of all of securities in general in the commercial market.

We will assume you request it unless you want to frame it any differently.

MR. SILVERMAN: That is my request, thank you.

THE COURT: Anybody wish to say anything?

MR. KELLY: I don't question the fact that the witness is an expert.

MR. TESSLER: Your Honor, I certainly would and I would like the opportunity to conduct a short voir dire in that connection.

THE COURT: You may.

VOIR DIRE EXAMINATION

BY MR. TESSLER:

Q Mr. Whitman, when you were with Shearson Hammill & Company, you were a securities analyst?

A Yes.

Q Part of your function was to evaluate certain securities?

A Yes.

Q In general, what types of securities were you asked to evaluate?

A Publicly traded common stocks.

Q Obviously. Were they listed or unlisted

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Whitman-direct

JA 130

securities?

A I don't think I can give you an accurate answer back that far. I could just speculate it would be a majority. It would be speculation on my part.

Q When you worked with Mr. Rosenwald, Mr. Rosenwald I believe you testified was a substantial investor?

A Yes.

Q Did you evaluate his portfolio?

A Yes.

Q What percentage of Mr. Rosenwald's portfolio consisted of listed securities? Was it more or less than 50 percent?

A Mr. Rosenfeld had two types of portfolios, in effect, one which would be controlled companies which I would suspect is not relevant here. The second would be marketable securities within the market. Within the marketable securities at that time, the emphasis in the portfolio was on the convertible securities. While many of them would have been listed because they were convertible debentures, the majority of trading would have taken place in the over-the-counter market.

THE COURT: Were they securities of corporations which in some form or other had securities listed?

THE WITNESS: In the majority of cases, yes,

rkbr 20

Whitman-direct

JA 131

I would be sure of that.

Q When you were a general partner of Gertzley, Sunstein, I believe you testified they were a New York Stock Exchange house?

A Yes.

Q When you were head of research for them, did you research mainly listed or non-listed securities?

A I can't say for sure. My speculation would be that there the majority of securities I researched would have been over-the-counter. Certainly most of the interest would have been over-the-counter.

THE COURT: That is from 1960 to 1967?

THE WITNESS: Yes.

A (Continuing) Again, I am speculating. I am just going through the list of what I was recommending or what we were doing at that time.

Q Your testimony as far as you recall is that you were largely recommending over-the-counter stocks at that time?

A Can I say maybe a little more than 50-50? I would really have to do a study.

Q When you were with Ladenburg, Thalmann, they were a New York Stock Exchange house, were they not?

A Yes.

1 rkbr 21

Whitman-direct

2 Q When you did research for them, did you largely
3 research listed or unlisted securities?

4 A Again, that would be hard to say.

5 Q What is your best recollection, sir?

6 A Porbably listed.

7 Q With respect to your criteria as to a better
8 quality portfolio, you mentioned the larger the size of the
9 company -- that is one criteria?

10 A Yes.

11 Q Are listed securities larger or smaller in
12 size than non-listed securities, as a general rule?

13 A As a general rule, they are larger.

14 Q As a general rule, are listed -- does the
15 company have more or less seasoning than unlisted securities?

16 A As a general rule, more seasoning among
17 industrial companies.

18 Q I am sorry?

19 A Among industrial companies.

20 Q I was talking between listed and unlisted
21 companies.

22 A I was just trying to abstract from banks and
23 insurance companies about seasoning.

24 Q Are companies that are listed, are they
25 generally companies that have been in existence a lot longer

1 rkbr 22

Whitman-direct

JA 133

2 than companies that are not listed on an organized exchange,
3 as a general rule?

4 A Yes, except for banks and insurance companies.

5 Q As a general rule, isn't it true that listed
6 companies are more likely to pay dividends than unlisted
7 companies?

8 A I would think so.

9 Q As a general rule since you talked about a
10 five-year earnings record as being important in determining
11 the quality of an issue, sir, as a general rule are companies
12 listed or unlisted in the first five years of their ex-
13 istence?

14 Would you like me to rephrase it?

15 A Yes, please.

16 Q Could you answer as a general rule whether
17 companies that have been in business and have been profit-
18 able for less than five years are more likely to be found on
19 a listed exchange or on the over-the-counter exchange?

20 A You mean among public companies?

21 Q Yes.

22 A I would think they would likely be on an ex-
23 change if they have been in existence for a long time?

24 A As

25 Q As a general rule, sir, is there likely to be

rkbr 23

Whitman-direct

JA 134

more market information and is that information more likely to be available to a passive outside investor, to use your term, with respect to to a security of a company that is registered on an organized exchange or a company trading on the over-the-counter market?

A There would be more information on a company on the Exchange.

Q As a general rule, is it not so that the type of company you have described is a better quality issue in a portfolio is more likely to be found trading on a listed exchange than the over-the-counter market?

A Yes, that would be true.

MR. SILVERMAN: If your Honor please, isn't that more in the nature of cross examination than voir dire?

THE COURT: Yes, to some extent, but I think it laid the basis for his last inquiry.

Let's see if Mr. Silverman wants to make some inquiry behind you at this point, still on the qualification issue.

BY MR. SILVERMAN:

Q Mr. Whitman, have you ever been called upon to prepare written analysis as to the quality of various securities?

rkbr 24

Whitman-direct

JA 135

A Yes.

Q Has your analysis dealt with unlisted securities as well as listed securities?

A Yes.

Q Have you ever prepared prior to my request to you in connection with this case, an analysis of a security that fell within the lows of the low categories as you have described it?

A Yes.

Q For whom have you performed these services?

A I would say every employer, insofar as they were broker-dealers. It would be Shearson-Hamill, Ladenburg Thalmann, certainly Gertzley, Sunstein.

THE COURT: Mr. Whitman, I think the point that Mr. Tessler has been driving at in his questions put to you, is whether or not the standards which you have indicated you have applied in analyzing the securities purchased during a particular period are not standards which are applicable to, they would be called blue chip stocks? In any event, the listed securities rather than unlisted or over-the-counter type shares?

Do you follow?

THE WITNESS: Yes. Your Honor, that line of inquiry really isn't relevant.

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Whitman-direct

JA 136

1 rkbr 25 Whitman-direct JA 136
2 THE COURT: It isn't relevant on the expert
3 question.

4 The question is whether you applied the same
5 standards to the listed shares, if there were any, as you
6 applied to over-the-counter shares or whatever they were,
7 the non-listed shares, or is there some different kind of
8 standard or set of standards which must be applied in
9 evaluating the value of non-listed shares? They have
10 a legitimate market also, correct?

11 THE WITNESS: Correct.

12 THE COURT: Are you applying the same standards
13 to both types of shares and is that a proper thing to do
14 wherein a case such as this, we will hear that there have
15 been both types of shares and counsel would have the Court
16 draw certain conclusions about that.

17 THE WITNESS: Your Honor, as I understood my
18 assignment, it was to look at the quality of shares from
19 the point of view of the investor. The investor I suppose
20 cares about the quality of the issuer and it is not rele-
21 vant to him whether it is over-the-counter or listed on an
22 organized exchange.

23 As to inquiry about blue chip, the relevant
24 standards there I would think would be between maybe
25 degrees of high quality and low quality.

1 A blue type analysis wouldn't be relevant to the
2 lowest of the low which is what the last inquiry was about.
3 I did apply the same standards.
4

5 THE COURT: Let me ask you, take over-the-
6 counter stocks. Would there be over-the-counter stocks
7 which are high, reasonable quality issues in accordance
8 with the standards which you say you have applied?

9 THE WITNESS: Oh my goodness, yes.

10 THE COURT: Would that be true also with
11 reference to low quality shares?

12 THE WITNESS: Yes.

13 THE COURT: And the lows of the low? In
14 other words, your standards would apply to shares, secur-
15 ities, rather, regardless whether they are blue chip, listed
16 or on the Exchange, is that so?

17 THE WITNESS: That is correct.

18 If I may explain --

19 THE COURT: But you have indicated being listed
20 is an important factor in your weighting of what is high
21 value and what is of low value, is that not so?

22 THE WITNESS: Yes, partly because it gives you
23 disclosure and marketability, which I think has been pointed
24 out.

25 MR. KELLY: May I ask a short series of

rkbr 27

Whitman-direct

JA 138

questions?

THE COURT: Let me just say again, we have two different transactions going here. We should have pursued the expert's track first, then at some next stage go into the standards or maybe it is just as well.

MR. SILVERMAN: I apologize for any confusion. What I wanted to do was set forth what he would be testifying to before I asked his opinion as to the grades of it so there would be a basis?

MR. KELLY: The questions I want to ask relate to that second track.

BY MR. KELLY:

Q Mr. Whitman, did I correctly hear you say that at the evaluation that you placed was based upon your understanding of what was a quality stock to this investor?

A As to any investor.

Q In other words, are you saying that the standards you are applying as respects quality, good or bad, you are saying exists whether the investor is Dr. Rolf, the Chase Manhattan Bank or me?

A I would say they exist for an outside passive non-control investor.

Q Then it is these standards you are using which are not standards applicable to every investor?

rkbr 28

Whitman-direct

JA 139

1 A No, they would not be applicable to insiders.

2 Q Let us determine some others. You say it
3 wouldn't apply to the Chase Manhattan Bank?

4 A I didn't say that.

5 Q The standards that you used are not standards
6 that you would apply if the investor were the Chase
7 Manhattan Bank?

8 A That is not true. I would suspect if it was
9 a trust department, it very well would apply and if it was
10 their commercial department making a secured loan,
11 probably it wouldn't apply. It is an outside passive invest-
12 or.

13 Q You wouldn't call Chase Manhattan Bank an outside
14 passive investor?

15 A Their trust department?

16 Q Yes.

17 A That just invests in marketable securities?

18 Q Yes.

19 A Of course, I would.

20 Q Your definition of an outside passive investor
21 is anything that is not an insider?

22 A No.

23 Q I would like to know what is a passive investor?

24 A A passive investor, outside passive investor
25

1 rkbr 29

Whitman-direct

JA 140

2 is someone who buys and sells securities in ordinary market
3 transactions in orderly markets, exercizes no control over
4 either the market in which he invests or the company in
5 which he invests and who invests based on legally
6 available disclosures that he uses.

7 Q You have just picked up every one of the other
8 standards you explained before. We are talking now only
9 about the investor that you are now going to establish a
10 quality rating on what he wished.

11 Define for me what a passive investor is.

12 MR.SILVERMAN: Objection. Asked and answered.

13 THE COURT: Sustained.

14 Q In the market place of listed and non-listed
15 securities, tell me those who would be buyers or seller who
16 you would consider not passive investors, excluding the ones
17 you have excluded, insiders. Who else?

18 A Market makers.

19 Q Who else?

20 A The professionals in the market.

21 Q Who else?

22 A People buying private placements. People
23 buying by methods other than open market transactions such
24 as tender offers, special bids, selling special offers,
25 special lists.

1 rkbr 30

Whitman-direct JA 141

2 Q And all the other buyers and sellers in the
3 marketplace are what you call passive investors?

4 A I think I positively defined them.

5 I can't sit on the witness stand not having
6 thought about this thing for many months and be all inclusive
7 but I am trying to be all inclusive as I can.

8 I defined an outside passive investor and I
9 don't know at this moment that I can cover the whole universe
10 of who I would not consider an outside passive investor.

11 MR. SILVERMAN: Your Honor, I understood
12 that Mr. Kelly said he had no objections to this witness'
13 qualifications.

14 THE COURT: He has reconsidered.

15 Go ahead.

16 Q That whole range of passive investors as you
17 have defined it, are the investors whose standards, objectives
18 or benefits are what you have used as the measuring test of
19 quality; is that correct?

20 A I am sorry, I don't understand that question.

21 Q You have said quality relates to a particular
22 kind of investor, correct?

23 A No, sir. Quality relates to an issue.

24 Q Or an investor, that is what I am trying to
25 find out.

1 rkbr 31

Whitman-direct

JA 142

2 A It is the quality of the issue and the impact
3 is on the investor.

4 Q I want to know whether or not your rating
5 of quality is a rating of a security as respects the issuer
6 or a rating as respects the investor?

7 A It is a rating as respects the issue and how
8 it impacts the investor.

9 An issue, for example, could be low quality
10 or lowest of the low and I would not be interested in it
11 as an outside passive investor for any reason.

12 Q I understand that.

13 A Please let me finish.

14 But if I were to be a controlled buy and used
15 that issue, I have just bought that issue as an outside
16 passive investor; if I was to be a control buyer and use
17 that as a vehicle for, I don't know what, I might bring
18 different standards to it than if I were just an outside pass-
19 ive investor.

20 THE COURT: Can we bring to to a head now?

21 MR. TESSLER: May I ask one or two questions?

22 THE COURT: Yes.

23 BY MR. TESSLER:

24 Q Mr. Whitman, in evaluating Dr. Rolf's security
25 portfolio --

rkbr 32

Whitman-direct

JA 143

THE COURT: You are on the question of his general expertise.

MR. TESSLER: I understand that, your Honor.

Q Did you evaluate those securities by those criteria that you deem important to the desires of an outside passive investor?

A Yes.

Q And did you use any other criterias, sir?

A In doing the evaluation of the quality of the issue?

Q Yes. Did you use criteria that would have been important not to an outside passive investor but to an insider?

A No, I did not.

Q Did you use criteria that would have been important to a market maker?

A I have to backtrack my last answer.

These criteria may or may not be important to an outside passive investor. I suspect they would be. They might not have the same degree of relevance. I don't want to say that these criteria used were unimportant to other types of people who buy and sell securities.

Q Very simply, in evaluating securities, in preparation for your testimony this morning and in determining,

1 choosing, selecting the criteria you would use in that
2 evaluation, is it fair to say that you assumed that the
3 plaintiff in this case, Dr. Rolf, was an outside passive
4 investor?
5

6 MR. SILVERMAN: Objection.

7 THE COURT: Sustained.

8 That is beyond the scope of voir dire.

9 MR. TESSLER: Your Honor, may I be heard?

10 I think it is important because in determining whether this
11 is an expert in evaluating the quality of this portfolio,
12 is able to evaluate the quality of this portfolio for the
13 plaintiff, I think the fact that he assumed plaintiff was
14 or was not a certain type of investor goes to the very
15 core of the question.

16 THE COURT: Go ahead.

17 MR. TESSLER: There certainly has been no
18 testimony given here on Dr. Rolf's direct examination to
19 allow this Court to determine at this stage that Dr. Rolf
20 was an outside passive investor.

21 THE COURT: Part of the problem is, and
22 you have tried many cases, the evidenc comes in in pieces a
23 we have to wait to see what we have when all of the evidenc
24 is in. It may be that what you are saying is correct.
25 I don't know what is coming in the future. If some proble

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1 in that respect, you can make the point again at the end
2 of the trial or at some appropriate point during the trial.

3 Anything further on this inquiry as to the
4 ability or expertness if you will of this witness to
5 testify in the manner in which Mr. Silverman would have him
6 found qualified by the Court to testify as an expert?

7 MR. TESSLER: In view of your Honor's ruling,
8 I would like to state the grounds of my objection to the
9 qualification of this witness as an expert on the security
10 evaluation in this particular litigation.

11 THE COURT: Go ahead.

12 MR. TESSLER: I think your Honor that the witness
13 has testified that the analysis of securities that he has
14 been most familiar with are those of listed as opposed
15 to non-listed securities, No. 1.

16 I think the witness has further testified that
17 in determining the criteria used to reach an opinion about
18 which Mr. Silverman wishes that he testify, he used
19 criteria which were in his words I think are fair to say,
20 are far more applicable to listed as opposed to unlisted se-
21 curities.

22 Thirdly, I think from the witness' testimony,
23 it is clear that this particular witness has ability in
24 buys that listed securities are of a higher quality
25

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2 as a general statement than n on-listed securities, and I
3 certainly don't argue with the witness' right to have that
4 opinion.

5 However, I think the Court must take judicial
6 notice of the fact that the securities purchased for
7 Dr. Rolf's account during the period that my client was
8 Dr. Rolf's investment advisor, to use a term which has been
9 used yesterday, were, by and large, over-the-counter unlisted
10 securities, new issues, securities of company with little
11 earnings records, where securities of companies that earned
12 little, et cetera, et cetera.

13 THE COURT: Bring it to a head.

14 MR. TESSLER: Since there was no testimony
15 that the good doctor did not know the type of securities
16 that were being purchased for his account, it would be a
17 terrible mistake to allow a person with the biases
18 that Mr. Whitman has and the qualifications that Mr. Whitman
19 has to testify as an expert on the security portfolio in this
20 particular case.

21 THE COURT: Mr. Kelly?

22 MR. KELLY: Your Honor, I stand on the position
23 that the witness is an expert. As to the relevancy which
24 is the second track I think we are pursuing, I will reserve
25 on that because I don't know as of yet it is sufficiently

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2 developed.

3 THE COURT: I am inclined to agree.

4 I declare Mr. Whitman to be an expert as
5 requested.

6 Let's proceed.

7 BY MR. SILVERMAN:

8 Q Mr. Whitman, in your review of the securities
9 purchased in Dr. Rolf's account during the relevant
10 period, did you find that any such securities fell within
11 the category of lows of the low?

12 MR. KELLY: I will object again. I know what is
13 going to happen. We are going to get a number. I don't
14 know what number it is going to be. Ten. Ten out of what?
15 There is no way for me to determine out of what because
16 I don't know what portfolio we are talking about.

17 I think it is absolutely imperative in
18 connection with the description of what proportion of bad
19 stuff is there, that I be in a position to know what is
20 the 100 percent? What portfolio are we judging?
21 I don't know.

22 THE COURT: If that is so, why is that a failure
23 of proof on the plaintiff's part rather than a matter that
24 should impede him from going further.

25 MR. KELLY: But I think we may get to it

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2 later after which this numbers game is finished.

3 THE COURT: Then you will have your shot at
4 it and make your record accordingly.

5 MR. SILVERMAN: Would the reporter read the
6 question?

(Read back.)

7
8 A 15 issues were declared lows of the low.

9 Q How many issues did you review?

10 A 46.

11 Q Will you name, can you name for us the 15
12 issues you graded as lows of the low?

13 A Creative Polymer Products, Delanair Commo
14 Delanair Call --

15 Q Excuse me, Mr. Whitman, I am sorry to interrupt
16 you. When you name a security, would you also apply each
17 of the standards that you have testified to earlier as to
18 that security and tell us how you arrived at the classifi-
19 cation for that security as being lows of the low?

20 THE COURT: At ten of the hour, we will take
21 a recess.

22 A Creative Polymer Products. The stock was
23 not listed on an organized exchange. There were no
24 disclosures available, either in Standard & Poors Stock Guide
25 or Moody's Manual.

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Indeed, the December 1971 the Securities and Exchange directory of companies filing annual reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934, did not list Creative Polymer Products as a filing company.

The next issue --

THE COURT: As a what?

THE WITNESS: As a filing company, under Section 12 or 15.

Q What did that mean, it was not a filing company, Mr. Whitman?

A I don't really know except from a disclosure point of view --

MR. TESSLER: Objection to everything after "I don't really know."

THE COURT: Sustained.

Q Mr. Whitman, is there information that is required to be disclosed by a filing company?

A Yes.

Q Go on.

A Such information 10-Ks, proxy statements.

Q What does that information that you have just described tend to disclose?

A 10-Ks is an annual report. 8-Ks is a monthly

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report in the event of a material event. A proxy statement can be a mailing in case of vote via compliance with Section 14 of the Securities Act.

Q Go ahead.

A Delanair. Delanair Common and Delanair Calls. Delanair was not listed in Moody's manuals or in Standard & Poors Stock Guide except for a news item in 1970 which showed that Delanair had purchased 51 percent interest in Harvey Stores on a leverage basis. Harvey Stores itself showed sales of only 6 million 8, assets of 3 million 9 and net profits of \$340,000. No dividends. I don't have an earnings record.

MR. TESSLER: Your Honor, I am listening to this testimony, and I will try and state my objections very simply:

The witness is talking about particular dates, talking about disclosure and I assume he made his evaluation fairly recently to this trial. My objection is on the terms of relevance, since I think the only relevant question is what was available on the date that the stock was purchased or sold and not what happened at some subsequent date.

THE COURT: Yes and no.

I will accept your objection to the extent

1 that the witness will be limited in his answers initially
2 at least to address himself to the period in question,
3 because I think Mr. Kessler has a point.
4

5 It may be in a particular structure that a
6 broader period might be addressed, but basically I will
7 sustain the objection.

8 Q Mr. Whitman, did you understand that in doing your
9 review and determination, that you were using facts and
10 circumstances in existence at the time the securities were
11 purchased?

12 A Yes. When I refer to Moody's manuals, Standard
13 and Poors Stock Guide or the SEC directory, I refer to
14 material that existed contemporaneous with time evaluation.
15 I am not using their current stock guides. I am using
16 those that existed at that time.

17 Q Go ahead.

18 A Fire Fly Enterprises was not listed, nor was
19 Delanair. It was not listed in the Standard & Poors Stock
20 Guide and it was not in Moody's manuals for any time dur-
21 ing the relevant period.

22 Q What was its earnings record?

23 A I don't know.

24 Q Why is that?

25 A It was not disclosed in things that an outside

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passive investor would normally refer to and have easy access to.

Q There was no information on the size of its assets?

A I suppose they might have filed a 10-K but that would be very difficult to get a hold of. It is something that would detract from the quality as perceived by an outside passive investor.

MR. TESSLER: I move that entire answer be stricken.

THE COURT: I will strike the last part.

MR. TESSLER: The question was, and I would like to hear an answer. As I understand the question, it was and there was no information available to an outside investor. I think that is a yesr or no question. I would like to hear an answer.

THE COURT: What is the answer to that, sir?

THE WITNESS: There would have been a 10-K available.

Q Where is the 10-K filed?

A In Washington at the Securities and Exchange Commission.

Q Is it generally circulated around in your experience?

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2 A No.

3 Q Was it generally circulated around in 1969,
4 1970, 1971?

5 A No.

6 Q If an investor wanted to see the 10-K, where
7 would he have to go to see it?

8 A Either at the Securities Exchange Commission or
9 the regional office where the company filed or he would
10 have to call the Washington Service Bureau or Documentation
11 and pay the required duplicating fee to get a copy of it.

12 Q Go on, Mr. Whitman.

13 THE COURT: It is 10-F. We will take a rest
14 here.

15 (Recess.)

16 THE COURT: Proceed, Mr. Silverman -- before you
17 resume, let me make clear that the ruling which I have made
18 is a ruling which finds the witness qualified as an
19 expert as requested. I have not made any ruling with respect
20 to the criteria or standards applied.

21 I just want to make that clear.

22 MR.SILVERMAN: Of course, your Honor.

23 BY MR. SILVERMAN (Continuing):

24 Q Would you continue, Mr. Whitman.

25 A GPI Enterprises. There was no information

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1 available in either the Moody's manuals as they then ex-
2 isted or in the Standard & Poors Stock Guides for the period
3 the company was not listed and according to this 1971 SEC
4 Directory, the company's name was not contained in that
5 SEC Directory.
6

7 As to Hair Extension Center, as to size its
8 sales were under a million dollars. Assets were \$223,000
9 at a contemporaneous date. Net profits were an \$85,000
10 loss.

11 The company incorporated or started business
12 in 1968. It went public in 1969. It had not paid cash
13 dividends. It did not have five years of continuous profits.
14 It was not listed on an exchange and was not listed in
15 Standard & Poors Stock Guide.

16 Health Evaluation System, again like a number
17 I spoke of above, was not in Moody's, was not in Standard
18 & Poors and was not listed in the SEC directory of companies
19 that file annual reports or 10-Ks with the Commission, therefore
20 there was no information available.

21 Holobeam, Inc. had sales of \$2-1/2 million.
22 Assets at around \$10 million. Net profits, a current
23 figure was a \$2,400,000 loss. The business had been
24 incorporated or started in 1967. It went public in 1970.
25 No cash dividends paid. No five year earnings record.

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2 Stock not listed on an organized exchange. The issue was
3 carried in the Standard & Poors Stock Guide. Information
4 was contained there as well as in Moody's Manual about the
5 company.

6 International Health Sciences was neither in
7 the Stock Guide nor Moody's. There was no information about
8 it and of course it was not listed on an exchange.

9 The same was true for M.H. Studios, inc., in
10 addition to which the company was not listed in the
11 SEC Directory as an issuer filling annual reports with the
12 Commission.

13 Synchronox Corporation also was not listed
14 in Moody's Manuals or Standard & Poors, nor was it listed
15 on an organized stock exchange.

16 Tele Communications. Sales volume \$584,000 asset
17 size, \$440,000. Net profits were a loss of \$106,000.
18 The company had been incorporated or the business started
19 in 1964. It went public in 1968. No cash dividends.
20 No five-year record of continual profits. Not listed on
21 an exchange. Information not carried in Standard &
22 Poors Stock Guide.

23 Tranquilaire Mental Health. Its sales at this
24 period were \$170,000. Asset size 3 million 2. The net
25 profits were a loss of approximately \$200,000. Date of

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2 incorporation 1966. The company went public in 1970. No
3 cash dividends, no five-year continuous earnings record.
4 Not listed on an organized exchange and no information
5 disclosure available in Standard & Poors.

6 Visual Science, Inc. I have here for a sales
7 volume, nil.

8 MR. TESSLER: What date was that?

9 THE WITNESS: It is contemporaneous. I pulled
10 out what I could that was relatively recent from 1969 through
11 1971 Moody's Manuals for this size.

12 Q Go ahead, Mr. Whitman, please.

13 MR. TESSLER: Your Honor, we have a statement
14 that sales volume was nil. I think we are entitled to know
15 as of what date?

16 MR. SILVERMAN: Your Honor, he will have cross
17 examination and he can ask that on cross.

18 THE COURT: Do you have a period for which that
19 comment applies?

20 THE WITNESS: Yes, sir. It would be sometime
21 after 1969. Whatever information was contained in the 1970
22 or 1971 Moody's Manual. They apparently did not have
23 an income account. There was some other indication there.

24 Q Go ahead.

25 A Asset size, total assets approximately a

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million dollars. The business operated at a loss.

I indicate here without an income account, there is no precise statement on loss. The business was apparently started in 1969. I do not have information on when the company went public. No cash dividends paid. No five-year record of continuous profits. Not listed on an exchange and no information contained about the company in Standard & Poors.

Viatron Computer, a convertible issue was in the portfolio. It had sales of \$716,000, assets of an indeterminate size, probably because I didn't get a pro forma balance sheet to reflect the new issue. The net profits were a loss of \$9 million, which I know included some special writeoffs. The business had been started in 1967, it went public in 1968. No cash dividends, no five year record of continuous profit. Not listed on an exchange and information about the company was contained in Standard & Poors Stock Guide.

Q Would you now just once read each of the 15 securities that you have labelled lows of the low, just their names?

MR. TESSLER: Objection.

THE COURT: Sustained.

Q How many securities did you grade as lows of the

1 low?

2 A 15.

3 Q Have you discussed each of those 15 in your answer

4 A I believe so.

5 Q Would you identify by name each of the 15 that
6 you have graded lows of the low?

7 MR. TESSLER: Objection.

8 THE COURT: Sustained. If there are any
9 missing, making it up after lunch hour.

10 Q Mr. Whitman, did you total the purchases made
11 in Dr. Rolf's account during that period, the approximate
12 aggregate dollar amount?

13 MR. KELLY: I w-uld like to know what account
14 we are talking about.

15 THE COURT: Sustained.

16 Q In making your test of I believe you said
17 46 securities, did you aggregate the total purchase price
18 of those total 46 securities?

19 A Yes.

20 MR. KELLY: Objection, until I know what the
21 46 securities are.

22 MR. SILVERMAN: We can only do it one step at
23 a time.

24 THE COURT: I will allow it, go ahead.
25

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2 A Yes.

3 Q What was the aggregate purchase?

4 A A little over \$2-1/2 million.

5 Q What was the aggregate purchase prices of the
6 15 securities which you graded lows of the low?

7 A A little over \$800,000.

8 Q Mr. Whitman, in reviewing these securities
9 purchased in Dr. Rolf's account during the period, what docu-
10 ments if any did you refer to?

11 A There were documents you gave me that were copies
12 of handwritten lists of securities purchased by years
13 '69; '70 and '71.

14 Q Mr. Whitman, I show you three documents marked
15 for identification as Defendants' Exhibits BB, CC and DD
16 and I ask you if those three documents were the ones that you
17 reviewed in making your determination?

18 A Yes, they were, Mr. Silverman.

19 THE COURT: Are they marked?

20 MR.SILVERMAN: They are marked as Defendants'
21 Exhibits BB, CC and DD. I assume defendants marked them
22 because they some time wish to introduce them in evidence.

23 THE COURT: Were those the exclusive sources of
24 your information concerning this account?

25 THE WITNESS: Yes.

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2 Q Mr. Whitman, I will ask you to assume an investor
3 was a surgeon who is 60 years of age, whose investment
4 objectives are the preservation of capital and the increas-
5 ing of such capital by taking reasonable prudent risks, and
6 I will ask you further to assume that this surgeon has no
7 pension, is self-employed, has no inherited money, only his
8 own money that he earns and I will ask you to assume that
9 these purchases in the securities, these securities that
10 were purchased, represents surplus income.

11 Based upon those assumptions, do you have an
12 opinion as to whether the securities purchased which you
13 reviewed are suitable for such an investment?

14 MR. KELLY: Object to the question as to the fact
15 that what the witness is being asked to determine is a
16 conclusion that is before the Court to determine.

17 THE COURT: The Federal Rules of Evidence
18 permit it.

19 MR. TESSLER: Objection, your Honor, on the
20 basis that there has been no testimony that this type of
21 an investor adequately identifies the plaintiff in this
22 case.

23 THE COURT: I will overrule your objection, not th
24 the issue you raised is not an issue to be resolved in
25 certain fashions in this case, but I will allow this to

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1 come in.

2
3 MR. KELLY: May I make one comment further.

4 The question supposes the propriety, correct-
5 ness and admissibility of a set of documents. Those docu-
6 ments are not in evidence, and I will not on that account
7 object because I have indicated to Mr. Silverman my will-
8 ingness to cooperate in permitting this witness to go on and
9 I am therefore aware that Mr. Silverman will seek elsewhere
10 and through others, to qualify the foundation material
11 upon which the opinion is expressed.

12 I want to make clear my conviction that those
13 documents should not be permitted to go in evidence.
14 That doesn't mean they won't be, but I want it understood
15 if there is any validity to the point I make, if those
16 documents do not qualify, I intend to move to strike the
17 entire testimony of the expert.

18 THE COURT: We will face that at the time.

19 Is there some dispute about whether or not Dr.
20 Rolf did or did not purchase or have purchased for his
21 account the shares and in the amounts which were brought
22 to this witness' attention preliminary to him coming here
23 and testifying?

24 MR. KELLY: Certainly, your Honor, with
25 respect to the purchases that he is talking about, there were

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1 purchases to which reference was made which were not made in
2 his account at Eastman Dillon. There were purchases
3 made by the doctor during the period of time --

4 THE COURT: Acknowledging that. Acknowledging
5 that you have taken the position and continue to take
6 the position that these may not have been purchased
7 through or by or with the participation of the Blyth
8 Eastman.
9

10 MR. KELLY: Further, your Honor, there were
11 transactions in the purchase and sale of securities in
12 the period covered which are not included in the schedules
13 and are not included in the records which the witness is
14 testifying from.

15 THE COURT: Fine. That is all matters that can
16 be brought out by you if you choose to bring it out on your
17 own examination.

18 Anything else?

19 Objection is overruled.

20 Proceed.

21 A Yes, I do.

22 Q What is your opinion?

23 THE COURT: For such an investor?

24 MR. SILVERMAN: Yes.

25 Q What is your opinion?

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1
2 A These securities are unsuitable for such an
3 investor.

4 Q What is the basis of your opinion?

5 A I would say that lows of the low quality securities
6 are suitable investments only for an investor who is pre-
7 pared to take the risk of total loss and I think the
8 investor you described doesn't fit in that category.

9 Q Prior to testifying today, have you been afforded
10 an opportunity to meet with the plaintiff in this action,
11 Dr. David Rolf, and discuss with him his financial needs,
12 background, investment objectives, sources of income and
13 other factors which you in your professional opinion would
14 deem to be necessary in advising a man as to what invest-
15 ments to make?

16 MR. KELLY: I will object to that question as
17 irrelevant.

18 THE COURT: Sustained.

19 MR. SILVERMAN: May I be heard for a moment,
20 your Honor?

21 THE COURT: Yes.

22 MR. SILVERMAN: I believe that it is of importance
23 to this case that Mr. Whitman not only be able to testify
24 as to the suitability of that account for an investor under
25 the assumption of facts I have made, but also as

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2 corroboration to testify as to in his professional opinion,
3 whether such investments were suitable for this plaintiff.

4 For example, your Honor, if this were a negli-
5 gence case, a doctor could be on the stand and could
6 testify as to his expert opinion to the extent of an injury
7 and disease and disability and then he could also testify that
8 he investigated and examined the plaintiff and based upon
9 his investigation and examination, he found those facts.

10 Finally, your Honor, under the new rules of
11 evidence, the expert's opinion evidence does not have to
12 be based upon a hypothetical but it can be addressed
13 directly to the witness and to the way he thinks and
14 operates and his needs and desires.

15 This first question is a preliminary question.
16 It merely lays a foundation. It says to the witness, did
17 you discuss Dr. Rolf's need, did you get a portrait, were
18 you able to form a portrait of what his needs are.

19 THE COURT: The difficulty you are facing,
20 it may well be that Dr. Rolf was very detailed in dis-
21 cussing with the witness his situation first of all as he
22 sees it now, I don't know when this discussion would have
23 taken place, but assuming it took place in the recent past,
24 it may be very different in terms of what would have been
25 presented to the witness in such an exchange now as opposed

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1 to the period in question. Further, it may be that Dr. Rolf
2 disclosed much more information or much less information
3 than was available, reasonably available to any of the
4 defendants here.
5

6 I don't think it is proper, because you would
7 really have me draw certain conclusions which would impute
8 the knowledge of being known or knowable at the time questioned
9 by one of these defendants.

10 Sustained.

11 MR. SILVERMAN: I am sorry to persist, but
12 wouldn't that go to the weight your Honor might assign to
13 the evidence and not to whether it is relevant?

14 THE COURT: I don't think that is a weight
15 question, Mr. Silverman.

16 Put your next question.

17 If you did have such discussion, when did it
18 take place?

19 THE WITNESS: Sunday.

20 THE COURT: Next question.

21 MR. SILVERMAN: May I have it as an offer of
22 proof?

23 THE COURT: You made your offer and I made my
24 ruling.

25 Q Mr. Whitman, at my request and under your

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2 direction, was a study made to determine the turnover
3 rate in Dr. Rolf's account during the period May 1, 1969
4 through March 31, 1971?

5 A Yes.

6 MR. TESSLER: Objection.

7 MR. KELLY: I share that.

8 THE COURT: What is the objection?

9 MR. KELLY: I don't know what account we
10 are talking about.

11 THE COURT: We are sustained.

12 Q Mr. Whitman, at my request and acting under
13 your direction, to the best of your knowledge, with
14 brokerage statements, confirmations and monthly statements
15 reviewed to determine -- the brokerage statements and monthly
16 confirmation statements in Dr. Rolf's account, reviewed to
17 determine the turnover rate in that account during the
18 period May 1, 1969 through March 31, 1971?

19 MR. TESSLER: Objection.

20 THE COURT: It is still not quite past the problem
21 that is presented.

22 If you try to pin it down, you need to lay more
23 of a basis.

24 Q Mr. Whitman, was a study made of the turnover
25 rate in an account which purported to be, which purported to

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list the purchases and sales of securities for Dr. Rolf --

THE COURT: Excuse me.

Did you review certain brokerage statements and monthly confirmation statements in connection with a turnover rate study?

THE WITNESS: My assistant did.

MR. TESSLER: Your Honor, my objection which I haven't had the opportunity to state or the necessity until now, I have no idea what is meant by the phrase "turnover rate".

THE COURT: The witness can be asked to describe that.

MR. TESSLER: Isn't that preliminary to asking him if he made a study of the turnover rate.

THE COURT: If you think it is that important, we can get the definition.

What is a turnover rate study?

THE WITNESS: That is the cumulative value of the purchases divided by the cumulative monthly average value of a portfolio.

Q What did your study reveal is the turnover rate?

MR. KELLY: I object.

THE COURT: Sustained.

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2 The witness said he did use certain brokerage
3 statements, Mr. Silverman, and he used certain monthly
4 confirmation statements. If you plan to get this evidence
5 in, you will have to get on the record what those statements
6 are, get them identified in some fashion.

7 Q Can you identify the statements that were used?

8 A They were monthly account statements for each
9 month from May 1969 through February 1971.

10 MR. KELLY Whose? Can't you just ask what broker
11 ate firms?

12 THE COURT: I will be very surprised if the
13 missing piece isn't something that bears a number either
14 marked for identification or already in evidence. That is
15 our problem. We need to have some papers or know what he
16 reviewed. They can't cross examine if they don't know.

17 MR. SILVERMAN: Your Honor, there was an
18 agreement and understanding reached between counsel. I
19 have schedules prepared and are marked for identification
20 and ineed will come in and confirmations and the like but
21 I asked for Mr. Whitman to be called today out of turn
22 because he has to return to California.

23 THE COURT: Just identify them. If you have
24 an agreement, just get on the record what they are so we
25 know.

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2 MR. KELLY: Your Honor, I have no such agree-
3 ment.

4 THE COURT: You had particular pieces of
5 paper in your hand that were called statements that were
6 used to make this study, is that right?

7 THE WITNESS: No, your Honor.

8 THE COURT: You didn't pluck the information
9 out of the air?

10 THE WITNESS: No, your Honor. I was in California.
11 I sent one of my employees up to Mr. Silverman's office
12 with specific instructions --

13 THE COURT: Did he have monthly account
14 statements?

15 THE WITNESS: Yes.

16 MR. SILVERMAN: I ask to have marked as
17 Plaintiff's Exhibits 12, 13, and 14, three packages.
18 The first containing 224 brokerage firm confirmations and
19 containing four monthly statements and bearing on the
20 cover of the envelope, Rolf, 1969 Confirm Statements and
21 I ask it be marked Plaintiff's Exhibit 12 for identifi-
22 cation.

23 (Plaintiff's Exhibit 14 was marked for
24 identification.)

25 MR. SILVERMAN: I ask that a package containing

xx

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86 brokerage firm confirmations and 25 statements and bearing the title Rolf, 1970 Cohform Statements, be marked as Plaintiff's Exhibit 13 for identification.

(Plaintiff's Exhibit 13 was marked for identification.)

MR. SILVERMAN: I ask that a final package containing 85 brokerage confirmations and 40 monthly statements and headed Rolf, 1971, be marked as Plaintiff's Exhibit 14 for identification.

(Plaintiff's Exhibit 14 was marked for identification.)

Q - Mr. Whitman, I show you what has been marked for identification as Plaintiff's Exhibits 12, 13 and 14 and I ask you whether you can tell us if those are the monthly statements and confirmations that were used in making the turnover study?

THE COURT: Do you represent those are the ones you turned over to this witness' office?

MR. SILVERMAN: Yes, I do.

THE WITNESS: They seem to comport.

A These are confirmations and the figures that my assistant prepared are from the monthly account statements and what I am doing is going through and so far they seem to correlate so that they are in the same

1 rkbr 60 Whitman-direct JA 171

2 ball park where I take it there might be slight differences
3 from month to month because of a difference between trade
4 date and settlement date, but they seem to be very close,
5 approximately correct in what I have gone through so far.

6 THE COURT: You believe them to be the docu-
7 ments used in connection with this study as far as you
8 know by one of your associates?

9 THE WITNESS: Yes.

10 THE COURT: You didn't see them used so it is
11 your assumption?

12 THE WITNESS: Yes.

13 THE COURT: Do you mean it represents these were
14 the documents presents to this witness' office for purposes
15 of this study?

16 We have passed that particular problem reserving
17 any other objection you may have?

18 MR. KELLY: On the representation of counsel,
19 I have no problem only that far in that that is what was
20 used.

21 THE COURT: Yes.

22 Continue.

23 Q What did the turnover study reveal as to the turn-
24 over rate --

25 MR. KELLY: Are these documents being offered?

1 rkbr 62

Whitman-direct

JA 173

2 they come along premised upon that fact which I can't
3 demonstrate to your Honor is true although we know it is.

4 THE COURT: Let me then say you have your
5 right on cross examination to go into all of this. I will
6 just make the ruling it is not proper voir dire.

7 Why don't we interrupt, take the lunch hour and
8 resume at 2 o'clock.

9 (Luncheon recess.)

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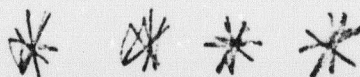
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1 rkbr 69

Rolf-cross

JA 174

2 1969 with a securities firm called Bear, Wall & DeBoer at
3 74th Street?

4 A Yes.

5 Q I show you Exhibit R, a set of confirmations
6 and R-1, a set of monthly statements, both of which
7 have been marked but not received, and I ask you if in
8 fact you opened an account with Hornblower & Weeks?

9 A Yes.

10 Q I believe, Doctor, and I don't ask you to con-
11 firm this, those accounts cover the period January '70 to
12 November '71. Is it your recollection that that account
13 was opened during the year 1970 and 1971?

14 A According to this, there is a trading date
15 here of January 28, 1970 but I don't remember how long I had
16 the account there.

17 Q You don't recall when that account was first
18 opened?

19 A No, I don't.

20 Q Do you know who placed orders in that account?

21 A Dick Friedman.

22 Q On whose direction?

23 A On my direction.

24 Q That was not a discretionary account?

25 A No.

rkbr 70

Rolf-cross

JA 175

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Q So that the securities that were purchased and sold there, were purchased and sold on your direct instructions?

A Yes.

Q Did Mr. Yamada have anything to do with the opening of that account?

A No.

Q In this account you bought these securities, Data Network, is that right?

A Yes, that is what it says.

MR. SILVERMAN: Objection. The document is assuming to be offered in evidence and it will show what the witness bought.

THE COURT: Overruled.

Q Did you buy Data Network?

A Yes.

Q Did you buy Mohawk Data Science?

A Yes.

Q Did you buy Daza Corporation?

A Yes.

Q Did you buy American Scientific Corporation?

A Yes.

Q Did you buy Mega Systems, Inc.?

A Yes.

1 rkbr 71

Rolf-cross

JA 176

2 Q Would you consider those securities blue
3 chips?

4 A No.

5 Q Would you call them high flyers?

6 MR.SILVERMAN: I object, your Honor.

7 THE COURT: Sustained.

8 Q Would you call them low quality?

9 MR .SILVERMAN: I object.

10 THE COURT: He can answer the question because
11 you understand it represents nothing more than a lay opinion.

12 MR. KELLY: If that does not mean it is not
13 an informed opinion, I will accept the fact he is not being
14 qualified as an expert.

15 THE COURT: Then the only other basis for asking
16 it is that you are asking it as a lay opinion and I will
17 receive it as a lay opinion.

18 MR.SILVERMAN: I also object because he hasn't
19 laid a foundation. He hasn't asked the witness whether
20 he knows what it is.

21 THE COURT: You can ask a predicate question
22 first.

23 Q Do you know anything about Daza Corporation?

24 A No.

25 Q Do you know anything about Mega Systems, Inc.?

1 rkbr 72 Rolf-cross JA 177

2 A No.

3 Q Doctor, I show you Plaintiff's Exhibit 3 which
4 has been marked in evidence. That is a letter dated
5 September 2, 1970 and written by you to Mr. Yamada. In
6 that letter you made two statements.

7 "I want to thank you sincerely for your ef-
8 forts in my behalf."

9 "You can be assured of my eternal gratitude for
10 your efforts."

11 Were those statements made to assure Yamada
12 that he had your trust and confidence and gratitude?

13 A At that time I thought Yamada was a very good
14 analyst.

15 Q In September of 1970, did Yamada have your trust
16 and confidence?

17 A Yes.

18 Q In September of 1970, did you consider Yamada
19 to be decent, honorable and trustworthy?

20 MR.SILVERMAN: Objection, your Honor.

21 THE COURT: We have been taking an awful lot
22 of evidence on direct as part of the plaintiff's case about
23 his impressions and his state of mind. It works both
24 ways.

25 MR. SILVERMAN: I will withdraw my objection.

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rkbr 73 Rolf-cross JA 178

A Would you repeat the question?

Q In September, Doctor, 1970, did you consider Yamada to be decent, honorable and trustworthy?

A Yes.

Q Just a few days before you wrote this letter, did you tell Mr. Stott that Yamada was decent, honorable, and trustworthy and did you also tell Stott that you were going to stick with Yamada?

A Yes.

Q In that discussion with Mr. Stott, did you tell him that it was your view that if you followed the plan and instructions of Yamada, you were sure you would come out ahead?

MR SILVERMAN: Objection. He is reading out of context from a whole letter. If he is going to give a discussion, he should put the whole letter in.

THE COURT_ Sustained.

MR. KELLY: I have merely asked a question as to whether in a discussion a certain statement was made.

THE COURT: Counselor, it is the easiest thing in the world to read it, starting with the beginning and finishing at the end.

Q Did you a few days before this letter was sent have a discussion with Mr. Stott in which in substance you

1 rkbr 73

Rolf-cross

JA 178

2 A Would you repeat the question?

3 Q In September, Doctor, 1970, did you consider
4 Yamada to be decent, honorable and trustworthy?

5 A Yes.

6 Q Just a few days before you wrote this letter,
7 did you tell Mr. Stott that Yamada was decent, honorable, and
8 trustworthy and did you also tell Stott that you were go-
9 ing to stick with Yamada?

10 A Yes.

11 Q In that discussion with Mr. Stott, did you tell
12 him that it was your view that if you followed the plan
13 and instructions of Yamada, you were sure you would come
14 out ahead?

15 MR SILVERMAN: Objection. He is reading out
16 of context from a whole letter. If he is going to give a
17 discussion, he should put the whole letter in.

18 THE COURT_ Sustained.

19 MR. KELLY: I have merely asked a question as
20 to whether in a discussion a certain statement was made.

21 THE COURT: Counselor, it is the easiest thing
22 in the world to read it, starting with the beginning
23 and finishing at the end.

24 Q Did you a few days before this letter was sent
25 have a discussion with Mr. Stott in which in substance you

1 rkbr 74

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2 told him, speaking of Yamada, that "I think he will not
3 only regain my equity but augment it," and further Tell
4 Stott that you were "going to stick with him" and you were
5 sure you would come out ahead?

6 A Yes.

7 Q In this letter you said to Yamada: "I do
8 appreciate some of your recent moves."

9 Can you tell me the purchases or sales to which
10 that refers?

11 A No.

12 Q I show you Exhibit D-14, a monthly statement'
13 of Eastman for June 1970 in evidence, Exhibit D-15 in evi-
14 dence, a monthly statement of Eastman Dillon for
15 July and Exhibit D-16, a monthly statement of Eastman
16 Dillon for August and ask you if that would help you in
17 determining what were the recent moves that Yamada made
18 which you appreciated?

19 MR SILVERMAN: Answer that yes or no.

20 A Let me have the question again, sir.

21 Q If you look at those three documents, does it
22 refresh your mind as to what you meant when you told
23 Yamada that you did appreciate some of his recent moves?

24 A No.

25 Q So that none of the securities that were there

[Handwritten marks]

Rolf-cross

JA 180

1 rkbr 77

2 kind of discussion occurred.

3 Do I recall your testimony or the facts incor-
4 rectly?

5 MR.SILVERMAN: Objection. If it is as counsel
6 recalls, it is already in evidence and I see no reason to go
7 over it.

8 THE COURT: I think he is right, Mr. Kelly.

9 MR.KELLY: He is right. I am not doing it for the
10 purposes of reconfirming it. I am doing it to see if the
11 witness remembers.

12 THE COURT: You are using this to establish --

13 MR. KELLY: To try and fix where and when.

14 THE COURT: Counsel is trying to help you.
15 Does it?

16 THE WITNESS: It might have been at that time,
17 I am not sure.

18 THE COURT: Let's see, your testimony according
19 to my notes yesterday on cross examination was that shortly
20 after Yamada took over the account, Yamada said we are going
21 to double or triple your investment.

22 Is that what you are talking about, Mr. Kelly?

23 MR KELLY: Yes.

24 I asked the question on cross first, did he
25 make that statement when he first met him and he did say

1 rkbr 78

Rolf-cross

JA 181

2 what you said and I think at the time I asked him that
3 question, he did again indicate it was at or about the time
4 that Yamada had sold that bulk of securities.

5 THE COURT: I think that is the case.

6 Where do we go from there?

7 Q Do you recall now that it occurred around the
8 summer of 1969?

9 A It might have been.

10 Q It wasn't any earlier than that, was it?

11 MR.SILVERMAN: Objection.

12 THE COURT: I will allow it.

13 A It is hard to remember the sequence of events.
14 It was somewhere in that period.

15 Q What period?

16 A In the summer of 1970.

17 Q 1969?

18 A 1969, I am sorry.

19 Q Did Mr. Yamada in discussions with you,
20 indicate that this was the objective which he was to
21 attain?

22 A Yes, in general.

23 Q Was that objective one that you asked him to
24 try to attain?

25 A I complained about my losses --

1 rkbr 79

Rolf-cross

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2 Q No.

3 MR.SILVERMAN: Let him finish the answer.

4 MR. KELLY: I don't want his answer unless
5 it is to my question.

6 MR SILVERMAN: How can he tell unless he
7 finishes.

8 THE COURT: The answer does not appear to be
9 responsive.

10 MR. KELLY: Would you read the question, please?
11 (Question read.)

12 A I asked him to recover my equity as far as
13 possible.

14 MR. TESSLER: I move to strike as not
15 responsive.

16 THE COURT: Strike it.
17 Put it again.

18 MR. KELLY: Would you read the question, please?
19 (Question read.)

20 A I asked him --

21 THE COURT: It really calls for, if you an, a
22 yes or no answer.

23 MR.SILVERMAN: If he has to make an explanation,
24 may he do so?

25 THE COURT: Maybe later down the line but right now

1 rkbr 80

Rolf-cross

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2 the question calls for yes, no, I don't know, I can't
3 remember or it wasn't important to me at the time so I don't
4 recall.

5 MR.SILVERMAN: Could we have yes, no, with an ex-
6 planation?

7 THE COURT: You can come back and bring it out.

8 MR SILVERMAN: I intend to.

9 THE COURT: What is the answer to the question?

10 A Yes.

11 Q Did you ever tell Mr. Stott that this was

12 Mr. Yamada's investment program and your investment ob-
13 jective?

14 A Yes.

15 Q When?

16 A I don't remember.

17 MR SILVERMAN: Can we get a fix on the time as
18 to when it was his program? Was it uniform, was it in
19 October, 1970, 1969?

20 THE COURT: Yes.

21 Q You have no idea when you told Mr. Stott
22 that this was Mr. Yamada's investment program and your
23 investment objective?

24 MR.SILVERMAN: Objection. I thought he was
25 going to first establish what time the conversation ap-

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peared.

THE COURT: Just change it to "Do you have any idea."

Do you have any idea timewise?

THE WITNESS: No.

THE COURT: You know it wasn't in 1965 or '55 and you know it wasn't this year, so we are down to at least some kind of a ten-year range. Can you narrow it as best you can?

THE WITNESS: I don't remember. It was after --

Q If you don't know when it occurred, do you know if it occurred at all?

A I am not sure.

Q You don't know whether you did tell Mr. Stott that at all?

A I am not sure.

Q In this letter of Septmeber 2, 1970, you refer in the last paragraph on the first page to the "plan" of Yamada. So far as that plan called for special situations, what did that involve?

A I don't know what Yamada meant by special situations.

Q Did you ever tell Mr. Stott of a Yamada plan involving special situations?

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Rolf-cross

MR. SILVERMAN: Object.

THE COURT: Overruled. At any time.

A Yes.

Q What did you tell Mr. Stott about special situations?

A I sent Mr. Stott an outline of what Mr. Yamada planned so he would know what his plans were since they were working together and he could follow it.

Q Did you know what special situations meant in this letter?

A No.

Q Do you know whether Mr. Stott knew what special situations meant?

A I don't know what Stott knows or doesn't know.

Q So far as the plan involved the liberal use of warrants in significant numbers, what was the dollar investment that was considered for such purpose, do you know?

A No.

Q Did Mr. Stott know?

A I don't know what Mr. Stott knew.

Q One of the warrants considered was Tranquilaire Mental Health. Did you favor that security?

A No.

Q You did not like it?

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1 rkbr 83

Rolf-cross

2 A I didn't know anything about it.

3 Q In the discussions you had with Mr. Yamada,
4 didn't he discuss it with you?

5 A Very superficially.

6 Q Another one was CPI. What was that?

7 A I think he said it was in the printing business,
8 but I didn't know anything about it.9 Q Another part of this plan was new issues and
10 founders stock.11 Will you tell me what discussions you had with
12 Mr. Yamada regarding that subject, or those two subjects?13 A Well, in this conversation Mr. Yamada mentioned
14 things and among those he mentioned founders stock and new
15 issues and I asked him what founders stock was, I never heard
16 these terms before.

17 Q And he explained it to you?

18 A Well, I really didn't understand it.

19 MR. TESSLER: Objection. I think that is not
20 responsive. The question was "And he explained it to you?"
21 The answer is either yes or no.22 MR. SILVERMAN: I object to the question.
23 It calls for a conclusion.24 THE COURT: I will sustain the objection.
25 Strike the answer.

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JA 187

You may proceed.

MR. SILVERMAN: Dr. Rolf is still on cross.

THE COURT: We will resume cross.

DAVID E. ROLF, resumed the stand,
having been previously duly sworn, testified
further as follows:

THE COURT: You are still under oath, Doctor.

THE WITNESS: Yes.

CROSS EXAMINATION

BY MR. KELLY (Continued):

Q Mr. Rolf --

MR. SILVERMAN: May Mr. Kelly identify what
page he is going to read and the line.

MR. KELLY: I will be delighted to.

Q Doctor, I am going to read from the transcript
page 389, line 20 to 390, line 6.

THE COURT: The plaintiff's deposition?

MR. KELLY: Yes.

MR. SILVERMAN: Your Honor, I object to reading
that portion because it is completely out of context
in time. This is after. There is no time frame set in
here. I know the time because I know it from other pages.

THE COURT: Stipulate the time and we can move
on. If you know the time, Mr. Kelly knows the time.

MR. KELLY: January of 1971 which is part of what I will read.

THE COURT: Proceed.

Q "Q Do you remember anything about that stock?

"A I remember, this was a period when I purchased four bank stocks.

"Q Was that Chemical Corporation, First Pennsylvania Corporation, Marine Midland Bank Corporation and one other?

"A Yes.

"Q Was the other P&B Corporation?

"A Yes.

"Q That was in January of 1971?

"A Right."

Doctor, do you recall testifying to that?

MR. SILVERMAN: Objection.

May I read the rest of what went on because it is relevant.

THE COURT: Is there much to it?

Six lines, eight lines?

MR. SILVERMAN: Just about eight lines.

THE COURT: Read it.

MR. SILVERMAN: "What led to the purchase of those four bank stocks?

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Rolf-cross

"A I had some enormous losses behind me and I wanted some conservative stocks.

"Q Did you make this known to anyone?

"A As I recall, I think Heely was a broker at Eastman Dillon. He was handling this account for a short period and I think I talked to Heely about this. I am not sure.

"Q At about the time you --

"A That I bought it.

"Q That you bought it?

"A Right.

"Q Do you recall anything that was said in that conversation?

"A No, except I was looking for a conservative bank stock."

THE COURT: Go ahead.

MR. TESSLER: Your Honor, insofar as this conversation or this series of questions is being offered as against -- as relating to my client, Defendant Yamada, I think there is no relationship at all.

THE COURT: That may be.

Go ahead.

Q Doctor, do you recall those four stocks, Chemical Corporation, First Pennsylvania, Marine Midland

1 rkrf 9

Rolf-cross

JA 190

2 and P&B Corporation as having been stocks that you ordered
3 be acquired?

4 A I bought those stocks but I don't remember on
5 whose recommendation.

6 Q I understand that, Doctor. What I am trying to
7 determine is, you did order those?

8 A Yes.

9 Q Those were different than the stocks that were
10 under Yamada's discretionary authority; is that right?

11 A Yes.

12 MR. SILVERMAN: Objection. This was January
13 1971. Mr. Yamada was not in the picture at that time.

14 THE COURT: Overruled.

15 Q Doctor, I will show you Exhibit O and Exhibit
16 HH, neither of which has been received in evidence at
17 this point.

18 These documents reflect an agreement you had
19 relating to Seijo Associates, is that right?

20 A Yes.

21 Q You will recall the other day I asked you if
22 you would produce for me a note that Mr. Yamada gave
23 you in connection with the Seijo matter. Have you been
24 able to locate that note?

25

CROSS EXAMINATION

BY MR. TESSLER:

Q Dr. Rolf, a few preliminary matters first, if I may.

This morning Mr. Kelly read to you from the transcript of your deposition with respect to the purchase of four bank stocks in January of 1971. I believe they were Chemical Corporation, First Pennsylvania Corporation, Marine Midland Bank Corporation and P&B Corporation.

Do you recall that?

A Yes.

Q Do you recall that sequence of questions and answers read to you this morning?

A Yes.

Q I would like to take up what you said additionally-

MR. TESSLER: Mr. Silverman, I am reading from page 390 of the plaintiff's transcript starting at line 20.

Q Do you recall being asked these questions and giving these answers:

"Q Do you recall anything that was said in that conversation?

"A No, except I was looking for a conservative bank stock.

"Q Why were you talking to Heely instead of Yamada?

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Rolf-cross

JA 192 301

"A Yamada was out of the picture. "

Now on page 391:

"Q This was in January of 1971?

"A Right.

"THE WITNESS: Wasn't he?

"MR. FRISCH: I don't know.

"THE WITNESS: As I recall.

"Q When you purchased these bank stocks in January
of 1971 --

"MR. FRISCH: What were the four stocks you were
referring to?

"MR. LYON: Off the record.

"A Whatever the account shows.

"Q I represent to you that was the month you
purchased them.

"A All right.

"Q At that time had Yamada ceased to be your
investment advisor?

"A In January 1971 you are talking about?

"Q Yes.

"A Yes, I think so."

Do you recall being asked those questions and
giving those answers?

A Yes.

1 Q Were those answers correct, sir?

2 A To the best of my recollection at that time.

3 Q And it is your recollection --

4 MR. SILVERMAN: Your Honor, may I read four or
5 five additional lines to put it in context?

6 THE COURT: All right.

7 MR. SILVERMAN:

8 "Q And who were you dealing with at Eastman Dillon
9 with respect to your account at Eastman Dillon?

10 "A I think I was dealing with Mr. Heely.

11 "Q Why not Mr. Stott?

12 "A Well, I had had enough of Mr. Stott and Mr.
13 Yamada at that time.

14 "Q We will get to that."

15 Q With respect to those bank stocks, Dr. Rolf,
16 was it your testimony that you purchased those stocks
17 without the advice of Mr. Yamada?

18 A To the best of my recollection, I purchased
19 those stocks without the advice of Mr. Yamada. To the
20 best of my recollection.

21 Q So if you had any loss on those stocks, it was
22 not through Mr. Yamada, isn't that correct, sir?

23 A Well, if I didn't purchase them through Mr.
24 Yamada, that is correct.
25

rkrf 37

Rolf-cross

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Q And it is your recollection that you did not purchase them through Mr. Yamada?

A Yes.

Q Is it your testimony that as of January 1971, to repeat your answer, you had had enough of Mr. Stott and Mr. Yamada at that time?

A Yes, that was my answer.

Q So any losses you had after January 1971 were not through Mr. Yamada, were they?

MR. SILVERMAN: I object. He could have had losses in stocks --

MR. TESSLER: Your Honor, this is cross.

THE COURT: The most unhelpful statement defense attorneys can give me on cross examination.

I will take it as his state of mine. It is not probative of much.

MR. TESSLER: I will offer his statements as to those bank stocks, your Honor.

Q With respect to the Delanair situation, you testified on your examination, according to my notes, Dr. Rolf, that Mr. Yamada paid you \$175,000. Mr. Yamada didn't pay any of that, did he?

A I thought I said that there were a group of them that paid that \$175,000. I mentioned, Mr. Heinie,



1 A I didn't make any remark that I was happy or
2 unhappy. I said here is a list of securities that Mr.
3 Sterling left.
4

5 Q Did you know the value of those securities at
6 that time?

7 A Well, our bookkeeper would keep track.

8 Q And tell you in the ordinary course --

9 A Yes, what they were.

10 Q Did you have any feeling at that time whether
11 you were happy or unhappy with those security holdings on
12 April 30, 1969?

13 A That was a period when Mr. Sterling was ill and
14 there was quite a depletion in the value of those securities.

15 Q My question, Dr. Rolf, were you happy or unhappy--

16 MR. SILVERMAN: May he answer his question his
17 own way then if it is not responsive, he can re-ask it.

18 Q My question is, were you happy or unhappy with
19 your security position at April 30, 1969?

20 A I had no particular feeling about my security
21 position. I was disturbed by the loss from the time Mr.
22 Sterling got ill and the time Mr. Yamada took over the
23 account.

24 Q There had been a loss between that period?

25 A Yes.

1 Q How much of a loss, sir?

2 A To the best of my recollection, there was about
3 a \$350,000 or \$400,000 loss.

4 Q As a matter of fact, Dr. Rolf, isn't one of
5 your claims in this action for over \$200,000 which you
6 alleged as damages sustained by you between October 1968
7 and April 30, 1969?

8 A Yes.

9 Q Before Mr. Yamada took over?

10 A Yes.

11 Q Was there any discussion between you and Mr.
12 Yamada at your first conversations with respect to the
13 liquidation of your security portfolio as that existed
14 as of April 30, 1969?

15 A He didn't say he was going to liquidate. He
16 said he was going to manage the account. He didn't make
17 any specific remarks about he was going to liquidate
18 or not liquidate.

19 Q Didn't you understand, Dr. Rolf, Mr. Yamada
20 was going to liquidate your security portfolio when he
21 took over?

22 A I assumed he was going to make changes. He didn't
23 use the word "liquidate."

24 Q You assumed he was going to make changes?

1 rkrf 43

Rolf-cross

2 A Yes.

3 Q And the purpose of those changes was to get
4 you a greater capital appreciation on your money than
5 you were getting at that time?

6 A Yes.

7 Q As a matter of fact, if you look at the
8 schedule, in May of 1969 Mr. Yamada liquidated your holdings
9 of 2,600 shares of Anaconda Company, did he not?

10 A Yes.

11 Q The proceeds received on that sale were
12 \$74,245 less than your cost for that stock, were they not?

13 A If that is what the record shows.

14 Q And in July of 1969 Mr. Yamada liquidated your
15 2,600 shares of Asamera Oil Corporation, did he not?

16 A Yes.

17 Q The proceeds you received on that sale were
18 \$14,473 less than the cost of that stock to you, is
19 that correct?

20 A Yes.

21 Q Mr. Yamada had nothing to do with your purchase
22 of that stock, isn't that also correct?

23 A Yes.

24 Q When you saw the -- by the way, when Mr. Yamada
25 effected a transaction for your account, you got copies

1 rkrf 44

Rolf-cross

2 of those confirmations, did you not?

3 A Yes.

4 Q When you saw the confirmation on Anaconda,
5 did you complain to Mr. Yamada that he shouldn't have
6 sold, yes or no?

7 A Not at that time, no.

8 Q When you saw the confirmation on Asamera, did
9 you make complaint to Mr. Yamada that he shouldn't have
10 sold?

11 A No, not at that time.

12 Q Going down further, the next stock on the list
13 was Avnet Corporation which was sold in November of 1969
14 and the proceeds you received from the sale of 7,489 shares
15 of Avnet were \$87,337 less than your investment in that
16 stock?

17 A Yes.

18 Q When you saw the confirmation on those sales,
19 Dr. Rolf, did you complain to Mr. Yamada?

20 A No.

21 Q You have a stock CNA Financial, 4,700 shares
22 which were sold in July of '69 and the proceeds you
23 received on that sale were \$13,525 less than you spent
24 on the stock?

25 A Yes.

1 rkrf 46

Rolf-cross

2 of 14 of those stocks were less than your investment in
3 those stocks, were they not?

4 A Yes.

5 Q And you made no complaint between May of 1969
6 and January of 1970 to Mr. Yamada that he was selling out
7 the Sterling portfolio?

8 A I didn't. I thought he knew what he was doing.

9 Q You made no complaints?

10 MR. SILVERMAN: Asked and answered, your Honor.

11 Q As a matter of fact, Dr. Rolf, the result of
12 Mr. Yamada's liquidation of the Sterling portfolio
13 between May of 1969 and January of 1970, resulted in your
14 receipt of proceeds which were \$129,875 less than your
15 cost for those stocks; isn't that correct?

16 A Yes.

17 Q And you made no complaint about those sales
18 at that time?

19 A Not at that time.

20 Q Were all of those stocks in your security
21 portfolio as of April 30, 1969 purchased by Mr. Sterling?

22 A Yes.

23 Q Who had discretionary authority over your
24 account?

25 A Yes.

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1 Q Did you make any complaint at the time he pur-
2 chased them?
3

4 A No.

5 Q I am reading now from paragraph 9 of your
6 complaint in this matter, Doctor, and it says:

7 "On April 30, 1969 plaintiff's investments
8 consisted of blue chip securities."

9 Are you in agreement with that statement?

10 A Yes.

11 Q That your investment portfolio at April 30,
12 1969 consisted of blue chip securities?

13 A That is my impression of it.

14 Q Did you know on that date you owned 2,000
15 shares of Penn Central Company?

16 A Yes.

17 Q What happened to Penn Central Company?

18 A They went bankrupt.

19 Q Did you know on that date you owned 1,000
20 shares of Levin Townsend Computer?

21 A Yes.

22 Q What happened to that company?

23 MR. SILVERMAN: I object to what happens at
24 some future time.

25 THE COURT: Sustained.

* * * *

period?

THE COURT: If the witness understands the question, you may answer it. If you don't understand it, I will ask him to rephrase it.

THE WITNESS: I think I can explain it.

A When I was managing my portfolio between 1950 and 1962, even putting in my surplus earnings in that portfolio, it took 12 years for the capital base to double and most of that came from my earnings so it couldn't have been very much from my efforts.

I thought it would be interesting if Mr. Sterling handled the account, how long it would take to double.

Q I am talking about a growth rate on an annual basis. Would you be happy with five per cent?

A I don't think so.

Q Would you be happy with ten per cent?

MR. SILVERMAN: Objection. The witness already stated he wasn't looking at it on an annual basis.

THE COURT: Overruled. We know more now than we knew before the questions were asked.

Q Would you have been happy with a ten per cent annual growth?

A Yes, I think so.

Q Dr. Rolf, what was the value of your security

* * * *

THE COURT: Please continue.

BY MR. TESSLER:

Q I show you, Dr. Rolf, Exhibit C in evidence which has been identified as a note from you to Mr. Sterling and would ask you to read to the Court the paragraph that I am pointing out?

A "My objective is to double my equity and it will be interesting to see how long it takes."

Q So your objective in 1967 was to double your equity?

A Well, as I explained --

Q Yes or no?

A Yes.

MR. SILVERMAN: If you can answer that. If you want to explain, please do.

THE COURT: He has his answer. You can bring out the explanation on your redirect.

MR. SILVERMAN: The reason I ask is because he read one sentence and not the second sentence, your Honor.

THE COURT: You read the second on redirect.

Q When you retained Mr. Yamada in April 1969, didn't you also tell him your objective was to double your equity?

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2 A No.

3 Q You made no such statement?

4 A No.

5 Q Did Mr. Yamada say he would try to double your
6 equity?

7 A Mr. Yamada stated that he would secure capital
8 gains for me but he didn't give me any specific figure.

9 Q When you invested in Delanair, you didn't expect
10 to make \$3 million in Delanair?

11 A I expected to make whatever Yamada told me I
12 would make.

13 Q Did you expect to make three and a half million
14 dollars?

15 A After listening to Yamada, I didn't know what
16 to expect.

17 Q Yes or no, did you expect to make three and a
18 half million dollars in Delanair?

19 A That is what Mr. Yamada told me.

20 MR. SILVERMAN: Objection. He is yelling and
21 abusing the witness.

22 THE COURT: There is no abuse, but keep your voice
23 down.

24 A That is what Mr. Yamada said he was going to do.

25 Q I show you the letter you wrote to Mr. Yamada

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2 on November 2, 1970 in which you said at one point,
3 "It was my impression we would wind up with three and
4 a half to five million dollars in a year's time."

5 Wasn't that your impression what your account
6 would do, the total of your account under Mr. Yamada's
7 stewardship?

8 A That is what Mr. Yamada said it was going to
9 do.

10 Q That is what Mr. Yamada said he would try to
11 do for you?

12 A Yes.

13 Q That was your hope, you would get from three
14 and a half to five million dollars?

15 A I wouldn't have any objection to it.

16 Q You hoped it would be that successful?

17 A Naturally I hoped.

18 Q In May of 1969, did Mr. Yamada tell you he was
19 running a hedge fund called Takara partners?

20 A He mentioned something about Takara.

21 Q He said it was a hedge fund?

22 A I don't remember the term but he said he had a
23 fund.

24 Q And that he had people, substantial people who
25 had given him money to invest for them in Takara Partners?

OK OK OK OK

1 rkrf 58

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2 correct?

3 A Yes.

4 Q With reference to the date on that letter, can
5 you tell the Court, please, when Mr. Yamada first spoke
6 to you about Delanair?

7 A I can't tell you exactly.

8 Q Approximately.

9 A Approximately a month before that time. It
10 was shortly before that time.

11 Q Somewhere around the end of June. Would that
12 be your recollection?

13 A Somewhere in that area.

14 Q Would you tell the Court as best you can recall,
15 what Mr. Yamada said to you about Delanair?

16 A He said that he knew Mr. Richter the president
17 very well, and, as a matter of fact, as I recall he said
18 that he regarded the man very highly. He said he thought
19 this was a situation which we would do very well. That
20 he had gotten his relatives to invest in it.

21 Q And he asked you to invest in it?

22 A Yes.

23 Q Did he tell you what you were being asked to
24 invest in was lettered stock?

25 A Yes.

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Q Did he tell you or did you ask him that that stock could not be freely sold in absence of a registration statement?

A I asked him what lettered stock meant and he said it couldn't be sold for two years.

Q Or in the absence of a registration statement?

A I don't know if he said anything about a registration statement.

Q Did he tell you the company had agreed to file a registration statement at a later date?

A He told me that they are going to issue a secondary and I presume he was referring to the registration statement.

Q He told you the company was going to issue a secondary?

A Yes.

Q And you knew, did you not, then, in the absence of that secondary, because Mr. Yamada told you, that you had to hold that stock for two years?

A Yes.

Q And in fact, that covenant was set forth in the subscription agreement, wasn't it?

A Yes.

Q So that not later than June 30, 1969, you knew,

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1 rkrf 60
2 did you not, Dr. Rolf, that Mr. Yamada was recommending
3 that you invest in lettered stock that with difficulty
4 could be sold?

5 MR. SILVERMAN: I object.

6 THE COURT: I will allow the question if you
7 reframe it.

8 Q As of June 30, 1969, approximately, Doctor,
9 you knew that Mr. Yamada was recommending that you invest
10 in lettered securities?

11 MR. SILVERMAN: Objection.

12 THE COURT: Overruled.

13 A Yes.

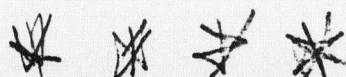
14 Q And you agreed with him?

15 A Yes.

16 THE COURT: Did you believe that that would
17 have any affect on the salability of the stock?

18 THE WITNESS: Your Honor, I didn't think about
19 that because Mr. Yamada had assured me there was
20 going to be a secondary and that this stock was going to
21 be sold with the secondary. This is what he told me and
22 I believed him.

23 Q With respect to that security, did you know
24 that you could not turn around the day after you bought
25 that stock and sell it?



1 about Delanair. Do you recall that?

2
3 A Yes.

4 Q Prior to your buying stock in Delanair and calls
5 in Delanair, Mr. Yamada explained to you that stock, didn't
6 he, told you you were buying private stock?

7 A Yes.

8 Q Did you discuss that with Mr. Stott?

9 A Yes, prior to the purchase, yes.

10 Q You had discussed it with Mr. Stott?

11 A Yes.

12 Q To your recollection, did Mr. Stott give you
13 any advice with respect to your purchase of Delanair?

14 A I asked him whether I ought to go into that
15 type -- I never heard of restricted, lettered stock. He
16 said, "If Yamada thinks it is okay, you can go ahead with
17 it."

18 Q During the period Mr. Yamada was managing your
19 account, he purchased many over-the-counter issues, I
20 believe you testified.

21 A Yes.

22 Q Issues you never heard of before?

23 A Yes.

24 Q Is it true that each time Mr. Yamada caused
25 your account to purchase a particular issue of stock, you

1 received a confirmation?

2
3 A Yes.

4 Q So that you at all times knew what Mr. Yamada
5 was doing with respect to your account?

6 MR. SILVERMAN: Objection.

7 THE COURT: Overruled.

8 A Yes.

9 Q When you received confirmations for stocks
10 you had never heard of, did you discuss them with Mr. Stott
11 on any occasion?

12 A Yes.

13 Q On how many occasions?

14 A I can't give you the exact number, but there
15 were frequent discussions.

16 Q To your recollection, what did Mr. Stott say
17 on these occasions?

18 A In general, he said that Mr. Yamada knew
19 what he was doing, that he was an excellent financial manag
20 and that I was going to come out all right.

21 Q Did Mr. Stott, to your recollection, ever
22 advise you not to go through with a trade that Mr. Yamada
23 recommended?

24 A No.

25 Q During the period from May --

* * *

REDIRECT EXAMINATION

BY MR. SILVERMAN:

Q Dr. Rolf, on cross-examination you testified that both Mr. Yamada and Mr. Stott were handling your account but then in answer to certain questions asked of you by Mr. Kelly you said you gave a trading authorization solely to Mr. Yamada, did you not?

A Yes.

Q If both Mr. Stott and Mr. Yamada were handling your account, why did you give the trading authorization solely to Mr. Yamada?

A Well, if both of them had trading authorization there might be chaos, one might be selling a security that the other one is buying.

Q What role was Mr. Stott to play in the management of your account?

MR. KELLY: Objection.

THE COURT: Overruled.

A Will you repeat the question?

Q What role was Mr. Stott to play?

A He was to supervise the account.

Q Did you tell Mr. Stott he was to supervise your account?

A Yes, sir.

1 Q When did you tell him so, for the first time?

2 A When we talked on the telephone and I told him
3 I was going to leave the securities at Eastman Dillon, just
4 like before, and was looking for an investment advisor,
5 Isaid, "Mr.Stott, you supervise the account."
6

7 Q Did you tell Mr.Stott at that time what duties
8 you expected him to perform in the way of supervising your
9 account?

10 MR. KELLY: Your Honor, I don't think the
11 witness should be led in this fashion. I don't mind it
12 when it is just leading up to something.

13 THE COURT: I will allow that question.

14 A I wanted him to get daily quotations on these
15 securities, I wanted him to notify me if there were any
16 changes that were pertinent which would adversely affect
17 me, I wanted him to notify me --

18 THE COURT: Are you telling us what you told
19 him?

20 THE WITNESS: Yes.

21 A -- if there were changes in the companies that
22 would be pertinent, I expected Mr.Stott to be in contact with
23 his research department and supervisors as the occasions
24 demanded, if he wanted information or something wasn't clear
25 to him or if he was worried about something.

Q Did Mr.Stott agree to perform those duties?

A Yes.

MR. KELLY: Your Honor, I don't think the witness should be led.

THE COURT: Yes. To introduce the subject area is all right, but once you have done that, let the witness answer. We are interested in what he has to say. What did Mr.Stott say or do after you told him these things?

THE WITNESS: I told Mr.Stott that "I am going to leave the securities here, just like we did with Mr. Sterling. You watch this account, you supervise it."

I said,"You are going to be getting all the commissions from these transactions and it is to your advantage to watch it carefully."

Q Did you have any occasion to remind Mr. Stott in writing of what you wished him to do?

A Yes. I wrote him a letter about that.

Q I show you Plaintiff's Exhibit 1 in evidence, and ask you if that is the letter you referred to in your prior answer.

A Yes.

THE COURT: This letter, 1 in evidence, do I gather correctly it was written approximately one year after you had first discussed with Mr.Stott getting an

investment advisor?

THE WITNESS: Yes, sir.

Q Was Mr. Stott to perform the role that you have just described in regard to all of your investments?

MR. KELLY: I object to the question, your Honor.

THE COURT: Yes. Mr. Stott was to perform the role you have described with respect to what investments?

THE WITNESS: Well, the investments that were initiated by Mr. Yamada.

Q Any other investments?

A No.

Q In cross-examination you testified there were certain accounts opened in firms other than Eastman Dillon and that you did not discuss the opening of these accounts prior thereto with Mr. Stott, is that correct?

A Yes.

Q What was your reason, if any, for not discussing the accounts at the time they were opened with Mr. Stott?

A Well, I believe that Mr. Stott and Mr. Yamada were working closely together and each one knew what the other one was doing.

Q Did you have occasion to discuss the accounts

opened in other brokerage firms after they were opened with Mr.Stott?

A Yes.

Q When was the first such occasion?

A After the account became active I noticed that the quality of the securities changed precipitously and I was worried about security, as to whether my account was secure with these small brokerage houses that I personally had never heard of.

Q Do you recall, to the best of your recollection, what you said to Mr.Stott and what he said to you and, if so, would you kindly give us your best recollection of the first conversation you had with Mr.Stott about the opening of the new accounts?

A Well, I was concerned about --

MR.KELLY: Could I find out when this conversation is, your Honor?

THE COURT: Yes.

Q Do you recall approximately when you had the first conversation with Mr. Stott about the opening of the new accounts?

A I think it was in the fall of '69, or somewhere in '69, when these other brokerage firms were brought into the picture and --

1 THE COURT: By whom?

2 THE WITNESS: By Mr. Yamada.

3 MR. KELLY: Could I hear the answer, your Honor?

4 I can't hear.

5 A By Mr. Yamada.

6 MR. KELLY: What was before that?

7 THE COURT: These other brokerage firms were
8 brought into the picture by Mr. Yamada in the fall of 1969.

9 THE WITNESS: Somewhere in that area.

10 A I was worried about security, whether all my
11 accounts should go through Eastman Dillon, and I was not su
12 Mr.Stott could supervise it if they were buying securities
13 at other houses.

14 Q What did Mr.Stott say to you?

15 A He said, "You have a custodial account and
16 it doesn't make any difference, all the securities go to
17 Eastman Dillon and all the money is paid out from them,
18 the transactions go across my desk and I can supervise
19 it just like before."

20 Q Did you ask Mr.Stott the reason, if any, for
21 trading in accounts other than Eastman Dillon?

22 A Yes. He said Eastman Dillon didn't engage --
23 trade in certain types of securities and I felt, well,
24 if Eastman Dillon didn't trade in the securities maybe they
25

1 didn't belong to my account.

2 Q Did you convey that feeling to Mr. Stott?

3 A Yes.

4 Q What did he say to you?

5 A He said, "Aki and I work closely together and
6 you don't have anything to worry about." He always said,
7 "You don't have anything to worry about, we know what we
8 are doing."
9

10 Q In May 1969 when you gave Mr. Yamaha a trading
11 authorization, did you have any doubts about turning your
12 portfolio over to him?

13 A Yes.

14 Q What was the basis of your doubts?

15 A Well, he was a young man. After all, at my
16 age, he was a youngster, only 26 years of age at that time,
17 and in my opinion he had a very limited background, couldn't
18 have been more than a few years, and he really didn't have
19 a large research institution or brokerage house, was not
20 affiliated with anyone that had any standing in the
21 community, and I never heard of the man. I heard of
22 Mr. Tobell and Mr. Sterling, but I never heard of Mr. Yamada
23 before.

24 Q At that time, May of 1969, did you have any
25 doubts about the trustworthiness of Eastman Dillon?

1
2 A No.

3 Q I show you what purports to be a copy of a
4 letter written by you to Mr. Michael Stott, dated
5 October 27, 1970, and marked Defendants' Exhibit H for
6 identification, and ask you, if you will, to read the letter
7 to yourself and indicate to me whether you have finished
8 doing so.

9 A Yes.

10 Q Do you recall whether or not you sent the original
11 of what Defendants' Exhibit H is a copy of to Mr.
12 Stott?

13 A Yes.

14 MR. SILVERMAN: I offer Defendants' Exhibit H
15 in evidence.

16 MR. KELLY: No objection.

xxx

17 (Defendants' Exhibit H was received in
18 evidence.)

19 Q In Defendants' Exhibit H you refer, do you
20 not, to the fact that you are reposing trust in Mr. Stott?
21 Did you on any prior occasion state that you were reposing
22 trust in Mr. Stott?

23 A Yes, I trusted Mr. Stott.

24 Q When did you tell him so?

25 A I told him on numerous occasions, "You are my

1 rmb

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2 man in New York and you watch my account, you take care
3 of it."

4 Q Did you tell him you were reposing trust in
5 him?

6 A Yes.

7 Q And in Eastman Dillon?

8 A Yes. I said, "We want everything to go through
9 Eastman Dillon, they are a reputable brokerage house and
10 are certainly great."

11 Q In cross-examination you testified that you
12 discussed your investments in Seljo with Stott and Eastman
13 Dillon. What was the reason, if any, for discussing that
14 investment with Stott and Eastman Dillon?

15 MR.KELLY: I object to this question, as to
16 reasons and motives and causes here -- this is the nature
17 of a brief, not redirect examination. I think we are
18 entitled to know the facts, not what the witness thinks.
19 It is what was said, what was done --

20 THE COURT: If it was a jury trial I would
21 have to be more concerned about it, Mr. Kelly. I will allow
22 it.

23 Q Do you recall the question?

24 A Restate the question, please.

25 Q What was your reason for discussing your invest-

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A At that time I had enormous losses in Monarch
tries and Yamada proposed to take -- as a matter of
to use exact figures, the loss was from 240,000 down
,000. There was a \$70,000 equity and Yamada said, "
restore your equity, I will put this in a hedge fund,
, and I have my father in it, my mother in it, my
er in it," and at that time I was worried and I said
.Stott, "What do you think, should I go ahead with
and he said, "Oh, yes, if he has his family in there,
now, he is a bright guy and he will do all right."

Q In cross-examination you testified you had as investment goal, which you communicated to Mr. Yamada, doubling of your equity, is that correct?

A Yes, but not taking undue risk, because I pointed out to Mr. Yamada repeatedly that the preservation of my capital was really my first goal, my first rule in investing and certainly if he could double it, fine, and the reason at that time was the fact that he had such enormous money in my account and he said, "I am not only going to double it," but he gave me an astronomical figure, more than double.

Q Did you specify any time period to Mr. Yamada
ch you wished your equity doubled?

1
2 MR. KELLY: Your Honor, I object. The witness
3 is being led. This is a brief, not a cross-examination --

4 THE COURT: I don't know how he would ask that
5 particular question if he didn't ask it in that fashion,
6 counselor.

7 A Restate your question, please.

8 Q Did you state any period of time in which you
9 wished your equity doubled?

10 A Not that I recall. I would imagine it was
11 some reasonable period of time.

12 Q Did you have any basis for believing that you
13 could accomplish a doubling of your equity by taking only
14 prudent risks?

15 THE COURT: No, I am not going to allow that
16 question.

17 Q Did you accomplish a doubling of your equity
18 between the years 1950 to 1962 when you were making decision
19 for your own account?

20 A Yes. We doubled our equity at that time but
21 I kept everything in there, I left -- I never withdrew
22 anything from that account, except the dividends, capital
23 gains and added my surplus earnings during those 12 years.

24 Q During the period that Mr. Sterling managed your
25 account, did your equity double?

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A Yes, it more than doubled.

Q Did you believe at that time, during the time Mr. Sterling was managing your account, that you were taking prudent risks?

MR. KELLY: Objection.

THE COURT: Sustained.

Q At the time Mr. Sterling was managing your account, what risks, if any, did you believe you were taking?

MR. KELLY: Objection.

THE COURT: Sustained.

Q Did Mr. Yamada ever inform you that you could achieve a doubling of your equity in a short period of time?

THE COURT: He just told us that -- what you want to know is, Yamada, the witness says, stated that he would double the equity, did he indicate any period of time when that would be done?

A The impression I had was it was going to be a short period of time.

THE COURT: That is an impression?

THE WITNESS: Yes.

Q Did Mr. Yamada explain to you at that time, when you formed the impression it would be a short period of time, what risks, if any, you would be asked to assume?

A During the entire period Stott and Yamada were

1
2 working together on this, I don't remember a single instance
3 not one, where there was any element of risk introduced,
4 where they said, "If you go into this, you might lose
5 everything you have." Everything was sort of pre-ordained.

6 Q Did you have a discussion during the period in
7 which Mr.Stott and Mr.Yamada were managing your account
8 with Mr.Stott concerning the element of risk?

9 A Yes. I told him to keep the risk to a minimum
10 "At my age I can't take any chance."

11 THE COURT: You never told that to Yamada?

12 THE WITNESS: Yes, in my first meeting.

13 THE COURT: Then risk was discussed?

14 THE WITNESS: In my first meeting with Mr.
15 Yamada I said, "Mr. Yamada, you know, preservation of my
16 capital, that is the first thing in investment, I have to be
17 careful."

18 THE COURT: The question asked a moment ago
19 was whether there had ever been an occasion when risk
20 was discussed with Mr. Yamada, and I gather your answer
21 is yes, it was discussed when you stated your objective goal

22 THE WITNESS: Yes, sir.

23 THE COURT: At the very outset.

24 THE WITNESS: Yes, sir.

25 THE COURT: What you are saying is, when

1
2 particular securities were recommended risk was not dis-
3 cussed by him with you or you with him?

4 THE WITNESS: Yes, sir.

5 THE COURT: Counsel is asking you if you ever
6 discussed risk with Mr.Stott. Do you understand that the
7 question is, when particular securities were recommended by
8 Mr.Yamada did you ever discuss with reference to those
9 particular securities risk?

10 THE WITNESS: When they bought securities I
11 always believed, you know --

12 THE COURT: No, that is a different matter.

13 THE WITNESS: I don't know how to explain that

14 THE COURT: We want to know the answer with
15 respect to Stott on the same question, and you have answered
16 as to Yamada. You said Yamada never discussed with you any
17 risk in relation to any of these stocks he recommended,
18 you said you didn't discuss anything with him about them.
19 The same question is being posed to Mr.Stott.

20 THE WITNESS: They never discussed any element
21 of risk regarding the purchase of any special security.

22 THE COURT: You didn't discuss any with them?

23 THE WITNESS: No, not any special risk.

24 Q In cross-examination Mr.Tessler asked you
25 whether you had complained about losses when the securities

1 which you had on hand as of May 1969 were sold and you
2 said you did not complain about those losses. Did you
3 complain subsequently about the reinvestment of the
4 proceeds of the sale of those securities?
5

6 A Oh, yes, many times, because the character and
7 quality of securities ju-t changed in such a striking
8 fashion and there were many discussions about it.

9 THE COURT: Who did you complain to?

10 THE WITNESS: I complained to both of them,
11 your Honor.

12 THE COURT: Did you ever cancel the trade autho
13 ization?

14 THE WITNESS: No, sir.

15 THE COURT: Did you ever cancel whatever the
16 arrangement was you had with Blyth Eastman?

17 THE WITNESS: No, sir.

18 THE COURT: Did you ever tell them, "I really
19 must put a stop to what you are doing here. You are
20 unloading all my good stuff and picking up a lot of bad
21 stuff"? Did you ever tell either of them that, Doctor?

22 THE WITNESS: I complained what was happening
23 in my account --

24 THE COURT: Did you ever tell them, "I have been
25 in the business 20 years, now cut it out"? Did you ever

1 write to them and explicitly state "No more of this"?
2

3 THE WITNESS: No.

4 THE COURT: What is the highest amount of money
5 you had invested in securities at one time, that is, market
6 value?

7 THE WITNESS: With Mr. Sterling --

8 THE COURT: In your whole investment career,
9 what is the total amount you ever had in securities in term
10 of market value?

11 THE WITNESS: I think with Mr. Sterling it was
12 about one million, seven.

13 THE COURT: What was it when he took over?

14 THE WITNESS: It was about \$450,000, roughly.

15 THE COURT: What was it when Sterling died?

16 THE WITNESS: It was about one mi-lion -- between
17 one million three, and one million four, somewhere in that
18 area.

19 THE COURT: What was it when your relationship
20 with Yamada terminated?

21 THE WITNESS: Oh, it was about, in round numbers
22 \$200,000.

23 THE COURT: That is all market value?

24 THE WITNESS: Yes, sir.

25 Q When you complained to Mr. Stott, do you recall,

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Rolf-redirect

JA 227

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to the best of your recollection, what you said to him and
what he said to you?

MR. KELLY: When?

A I had a --

MR. KELLY: Could I know when this conversation
was, your Honor?

THE COURT: Yes. Fix a time.

Q You answered previously that after securities
which were on hand --

A When Mr. Sterling's account was being liquidated

Q Yes. Then you said after proceeds were invest
you complained to Mr. Stott. When did you complain for the
first time?

A I can't give you an exact date, but soon after-
wards because I was very perturbed about the kind of
securities we were getting, Hair Extension, Mental
Tranquilaire, and these were not the kind of securities Mr.
Sterling had and from that point on there were just many
complaints.

Q Do you recall what Mr. Stott said to you?

A On most of these occasions Mr. Stott said that
Mr. Yamada was a superb financial manager, he knew what he
was doing, that he would restore my equity, I had nothing
to worry about. He gave me an example of one man who had

1 losses similar to mine and he said "He got his money back,"
2 and I said, "How did he do it?" And he said Mr. Yamada
3 controlled a lot of mutual funds and he took these
4 securities and placed them in the mutual funds and that
5 this man came out fine, and I had the impression he would do
6 the same for me.
7

8 Q Did you ever discuss with Mr. Stott the restoration
9 of losses in your account?

10 A Oh, yes, many times.

11 Q What, to the best of your recollection, did you
12 say about those losses and what did Mr. Stott say?

13 A I remember one occasion when I said, "Mike,
14 this operation doesn't make any sense. I don't know what
15 is going on, but it doesn't make any sense," and he always
16 said, "Look, you know what Yamada told you, no client of
17 his has lost a dime," and Yamada told me that, too, "No
18 client of mine has ever lost a dime."

19 THE COURT: Do you have much more?

20 MR. SILVERMAN: No, your Honor.

21 Thank you, Dr. Rolf.

22 (Recess.)
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Rolf-recross

JA 229

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I had losses in -- I don't recall the exact securities.

Q Are those a fair illustration of the causes for your distress?

MR. SILVERMAN: Objection.

THE COURT: Perhaps some more predicate question could be asked, Mr. Kelly.

Q Let's take those two securities and let's start with Delanair. Did Mr. Stott tell you anything about the business of Delanair?

A No.

Q Did he tell you about the prospects of Delanair?

A No.

Q Did he tell you about the management of Delanair?

A No.

Q Did he tell you about the earnings of Delanair?

A No.

MR. SILVERMAN: Your Honor, I object. This is going way beyond redirect and this is supposed to be limited recross, which is discretionary with your Honor after we have redirect, and he is asking broadside questions and nothing that was covered in redirect.

THE COURT: I will allow a little of this.

Q Did he tell you about what the business was of Delanair?

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Rolf-recross

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A No.

Q Did you ask him?

THE COURT: You are talking about a conversation with Yamada?

MR. KELLY: With Stott.

A I don't remember specific questions. I merely asked him whether I should invest in it and he said if Mr. Yamada thought it was all right, I ought to go ahead with it.

Q But he told you nothing about anything regarding the character of the company or the nature of the stock?

A Not that I recall.

Q Had you previously engaged in any purchase of securities other than in the public marketplace?

A I presume by that question you mean restricted securities?

Q Yes.

A No.

Q Had you previously bought stock from the shareholders of companies rather than in the public market?

A No.

Q Then who told you about this opportunity to invest in Delanair?

A Mr. Yamada.

1
2 Q How soon after he told you about Delanair
3 did you discuss Delanair with Mr. Stott?

4 A I can't tell you the exact time, but it was some
5 time between the time he discussed it with me and the time
6 when I had to pay for it.

7 Q Was it after you had agreed to invest that
8 you talked to Mr. Stott about it?

9 MR. SILVERMAN: Objection.

10 THE COURT: I will allow it. You may answer.

11 A Rephrase your question again, please.

12 Q After you had told Mr. Yamada that you wanted
13 to buy this Delanair stock, was it then that you talked
14 with Mr. Stott?

15 MR. SILVERMAN: Objection, your Honor. That
16 is not what the witness testified to. There is no founda-
17 tion for that and it is an unfair question on cross.

18 THE COURT: I understood Dr. Rolf to say that he
19 discussed it with Mr. Stott some time after Mr. Yamada
20 mentioned the purchase of Delanair to him and before he
21 committed the money to it.

22 MR. SILVERMAN: That is my recollection too,
23 your Honor.

24 THE COURT: Your objection is to what?

25 MR. SILVERMAN: To Mr. Kelly's question, "After

1 you made up your mind to invest in it, did you discuss it
2 with Mr.Stott?" If we can have the question read back,
3 you will see he is assuming facts not in evidence.
4

5 THE COURT: Dr. Rolf, you say that before you
6 committed your money to the purchase you discussed it
7 with Mr.Stott?

8 THE WITNESS: Yes, sir.

9 THE COURT: Can you tell us more exactly when
10 that discussion occurred, in relation to the purchase?

11 THE WITNESS: It involved a great deal of money
12 and before I committed that much I asked Mr.Stott whether
13 I should go ahead with it and he said yes, if Mr.Yamada
14 thought it was all right, it was okay to go ahead.

15 Q You recall you received an agreement to sign
16 with regard to Delanair?

17 A Yes.

18 Q And you received it by letter from Yamada?

19 A Yes.

20 Q You signed that agreement?

21 A Yes.

22 Q Before you signed that agreement, did you discu
23 Delanair with Mr. Stott?

24 A I can't give you that in point of time. I know
25 I was worried about it, and discussed it with Mr. Stott

and I can't recall --

Q You recall you asked Mr.Stott to pay for it?

A Yes.

Q Was it at that point that you asked him about it?

A I can't tell you in point of time. I remember at that time what happened was this, that I wanted that transaction to go through Eastman Dillon and Mr.Stott told me the transaction could not go through Eastman Dillon, and I would have to pay this legal firm, whatever it was, Marshall -- whatever the name of the firm was --

Q Marshall, Bratter?

A Yes. That is when it came up as to whether I should invest that much money and Mr.Stott said, "It is okay, if Mr. Yamada said okay, go ahead."

Q So at that point you told Mr.Stott to pay for the stock out of your account in Eastman Dillon?

A Yes.

Q And he told you he wouldn't do that?

A Yes.

Q He told you he would give the money to you if you wanted it?

A Yes.

Q And he gave it to you because you wanted it?

A He told me that is the only way the transaction

1 could be effected. I had never bought restricted stock
2 before, I didn't know how these things operated.
3

4 THE COURT: Did you get the money from him in
5 that fashion?

6 THE WITNESS: Yes, I got it from Eastman Dillon.

7 THE COURT: Did you then proceed to acquire the
8 stock in the manner which had been stated it would have
9 to be used?

10 THE WITNESS: Yes.

11 Q You drew your own check to pay for that stock?

12 A Yes.

13 Q And you deposited the money from Eastman Dillon
14 in your own bank account?

15 A Yes.

16 Q Because Mr.Stott told you that if Mr. Yamada
17 said it is good, it is good, that is what you say that
18 Mr.Stott was wrong in doing, correct?

19 A I didn't get the last part?

20 Q Am I correct in understanding your complaint
21 about Mr.Stott that he, as to Delanair, said to you, "If
22 Mr. Yamada says it is all right, then it is all right"?

23 MR. SILVERMAN: I object, your Honor. It
24 calls for a conclusion. He said time and again what his
25 basis for complaining about Mr.Stott was --

THE COURT: Read the question, please.

(Question read.)

THE COURT: Sustained.

Q Did Mr. Stott say anything to you with regard to your investing in Delanair other than that if Mr. Yamada says it is all right, then it is all right?

A That was the context of his conversation, yes.

Q That was the substance of what he told you?

A Yes, sir.

Q And he told you nothing else about Delanair?

A No.

Q Let's go to Monarch -- oh, incidentally, do you know how much commission Mr. Stott made on your transaction in Delanair?

MR. SILVERMAN: Objection.

THE COURT: Overruled.

MR. SILVERMAN: Your Honor, may I state the basis: There would be a record to show how much commission he made.

THE COURT: Maybe, but you have sought to elicit much about the witness' state of mind and I am interested in hearing this answer as bearing on the state of mind.

MR. SILVERMAN: I see.

A I assume that he made no commission in Delanair.

2 Q You knew that, didn't you, Doctor?

3 MR. SILVERMAN: Objection, asked and answered.

4 THE COURT: Sustained.

5 Q Let's go to Monarch. Do you know when Monarch
6 was bought, Doctor?

7 A In the fall of '69, I believe.

8 Q Where?

9 A Well, it was bought through various brokerage
10 houses.

11 Q Did you talk to Mr. Stott about Monarch before you
12 bought those securities at various brokerage houses?

13 A Not that I recall, no.

14 Q Did you ever talk to him about Monarch?

15 A Yes, many times, after it was bought.

16 Q When for the first time did you talk to him
17 about Monarch?

18 A Well, Monarch was one of my great losses and soon
19 after Monarch was bought the security began to decline in
20 price almost precipitously and there were many discussions
21 about that.

22 Q Were these discussions after you bought the
23 Monarch that you held?

24 A Yes.

25 Q You didn't talk to Mr. Stott about Monarch before

1
2 you made the investment?

3 MR. SILVERMAN: Objection. Asked and answered.

4 THE COURT: Sustained.

5 Q Do I understand that your testimony before
6 was that you talked with Mr. Stott about all of your pur-
7 chases?

8 A There were many discussions with Mr. Stott
9 about the purchases made in my account when the complexion
10 of the account changed from the type of securities Mr.
11 Sterling had to the type we had now, and it was a straight
12 downhill course, and during this period there was a tremen-
13 dous attrition in my account and there were many discussions
14 about those securities with Mr. Stott.

15 Q You mentioned Tranquilaire and Mental Health
16 as illustrative of the change in your account --

17 A There were other problems that were worse,
18 Funeral Homes of America and Hair Extension.

19 Q Let's talk about Funeral Homes of America.
20 Where was that bought?

21 MR. SILVERMAN: Objection. We have an exhibit
22 in evidence which shows that, your Honor.

23 THE COURT: Overruled.

24 A I believe it was bought at one of the small
25 securities --

2 MR. SILVERMAN: I move to strike it unless the
3 witness has personal knowledge as to where it was bought,
4 and he doesn't seem to have that.

5 THE COURT: Strike it.

6 Do you have personal knowledge of where it was
7 bought?

8 THE WITNESS: No.

9 Q Do you know it was not bought at Eastman Dillon?

10 A No, it wasn't bought there, but the securities
11 were delivered to Eastman Dillon.

12 Q Did you talk to Mr. Stott about that one before
13 you bought it?

14 A I don't remember any specific conversations
15 about that one, but I certainly complained --

16 Q Let's just talk about that one, Funeral Homes
17 of America. Before you bought it, did you talk to Mr.
18 Stott about it?

19 MR. SILVERMAN: I object to this whole line of
20 examination. There is a trading authorization in evidence
21 where Mr. Yamada had authority to buy and sell. He doesn't
22 talk to him even before he buys and there is no evidence
23 anybody told the doctor what he was going to buy before he
24 bought it. How could the doctor talk to anything about it?
25 This whole line of examination is irrelevant, your Honor.

THE COURT: Doctor, you may answer the question.

THE WITNESS: Will you ask the question again?

Q Did you talk to Mr.Stott about Funeral Homes
before you bought it?

A No, I didn't.

Q Did you talk to him about GPI before you bought i

A No.

Q Did you talk to him about Health Education
Systems before you bought it?

A No.

Q Did you talk to him about Hair Extension Centers
before you bought it?

A No.

Q Did you talk to him about Creative Polymer
before you bought it?

A No.

Q Did you talk to him about Firefly Enterprises
before you bought it?

A No. I didn't buy it, Mr.Yamada bought it.

THE COURT: Who paid for it?

THE WITNESS: I paid for it.

Q You got a confirmation?

A Yes.

Q You knew what you were buying, right?

* * * *

1 A From what Mr.Stott said I assumed that Eastman
2
3 Dillon would not deal in this type of security, or these
4 types of securities.

5 Q Are you telling me that Mr.Stott when he told
6 you that was recommending that you buy them?

7 A Mr.Yamada recommended the purchase of securities
8 to a large degree.

9 Q Mr.Stott did not recommend securities to you,
10 did he?

11 A Yes, he did.

12 Q Which ones, and I want to know all the ones he
13 recommended to you.

14 MR. SILVERMAN: Could we have a period of time,
15 your Honor?

16 THE COURT: Yes.

17 Q 1969 to 1971.

18 MR. SILVERMAN: You want to know what stocks --
19 your Honor, may we have the question rephrased.

20 THE COURT: Read the question back.

21 (Question read.)

22 A Well, Simplex Wire, I remember distinctly,
23 because he said his father was the president of the company.

24 Q What else?

25 A I think Carter Wallace -- I am not sure, I

think. There was an Oil Transmission Company in Canada or Gas Transmission Company in Canada, and there might have been a few other which I don't recall offhand.

Q How many others? One?

A I would say a few.

Q Two?

A Possibly, maybe, more or less.

Q Other than those, he didn't recommend securities that you had in your account, did he?

MR. SILVERMAN: Objection. It doesn't say recommend to whom, did he recommend to him or to Mr. Yamada.

THE COURT: Consider the question to mean recommend to you, Doctor.

A No, not that I can think of. You mean on the securities?

Q Other than the two you mentioned and a couple of more.

A Not that I recall.

MR. KELLY: No further questions.

THE COURT: Anything else, Mr. Tessler?

MR. TESSLER: Yes, your Honor.

REXCROSS-EXAMINATION

BY MR. TESSLER:

Q Doctor, you testified that you made complaints



1
2 Q I understand that, but I will go through
3 each security. I want to know if you made a complaint
4 when Mr. Yamada sold Creative Polymer Products two months
5 after he bought it.

6 MR. SILVERMAN: I object. It has been answered.
7 The witness said he didn't complain about every single
8 security, but complained about the losses as a whole.

9 THE COURT: It would be correct to say, Doctor,
10 that there was no single security which was purchased or
11 sold about which you made a complaint to Mr. Yamada?

12 THE WITNESS: Your Honor, with the exception
13 of two, Monarch and Delanair, because there was so much
14 money concentrated in those securities. With regard
15 to the others, I didn't know anything about them and I
16 complained as a group, but not specifically.

17 THE COURT: You did complain specifically about
18 Monarch and Delanair to Yamada?

19 THE WITNESS: After the losses became apparent,
20 not when he bought them.

21 Q Then your testimony, as I understand it, and
22 correct me if I am wrong, is that you made no complaint
23 to Mr. Yamada at the time he purchased any particular
24 security?

25 A That is true.

1 Q And that you made complaints to Mr. Yamada
2
3 thereafter when the losses became apparent?

4 A Yes.

5 Q Did you ever make complaints to Mr. Yamada
6 about the purchase or sale of any security in which he showed
7 a profit?

8 MR. SILVERMAN: Objection. We have been
9 through this. He said he didn't complain about --

10 THE COURT: I have understood the answer to
11 apply to both, shares which earned a profit and those which
12 resulted in a loss, and the witness now nods affirmatively.

13 Q When did you make complaints to Mr. Yamada,
14 if you recall, about his purchase and sale of Health
15 Evaluation Systems?

16 MR. SILVERMAN: I object. I don't know why
17 he is persisting when your Honor has ruled on it.

18 THE COURT: Yes, I think we have gone far enough
19 into that, Mr. Tessler. Any complaints made were addressed
20 to the loss of his portfolio as a whole, and then there
21 were specific complaints about Monarch and Delanair,
22 but all complaints occurred after the losses became appar-
23 ent and there were no complaints at the time the purchases
24 were made with reference to Monarch, Delanair or any
25 other security.

Now, what about where profits occurred, you made no complaint where there were profits?

THE WITNESS: No, sir.

MR. TESSLER: No further questions.

THE COURT: Anything further, Mr. Silverman?

MR. SILVERMAN: No, your Honor.

(Witness excused.)

THE COURT: Who is your next witness?

MR. SILVERMAN: Martin J. Whitman, your Honor.

MARTIN J. WHITMAN, recalled as a witness by the plaintiff, having been previously sworn, testified further as follows:

THE COURT: Your direct examination had been interrupted and we will resume continued direct examination.

DIRECT EXAMINATION (continued)

BY MR. SILVERMAN:

Q When you testified before you testified on the classification or the grading of securities and you had begun to testify about a turnover study made under your direction.

A That's correct.

Q Would you identify for us the data you used in making the turnover study?

A I had copies of Eastman Dillon, Union Securities

1
2 & Co., confirmations as to purchases and sales and Eastman
3 Dillon monthly statements, all of which were in the account
4 Dr. David E. Rolf, and such statements covered the period
5 starting May 1, 1969, and ending December 31, 1970.

6 Q Do you have copies of the material you have
7 just described with you?

8 A Yes, I do.

9 Q Are you handing them to me now?

10 A Yes, I am.

11 MR. SILVERMAN: I ask that the documents
12 handed to me by the witness be marked Plaintiff's Exhibit
13 15 for identification.

14 MR. KELLY: Are those the monthly statements?

15 MR. SILVERMAN: Your Honor, I think you asked
16 counsel address each other through your Honor.

17 THE COURT: I think that is a personal ques-
18 tion.

19 (Plaintiff's Exhibit 15 was marked for
20 identification.)

21 THE COURT: Describe them again, please.

22 Q Would you describe again the contents of the
23 material contained within Exhibit 15?

24 A They are monthly statements running from the
25 month of May 1969 through December 31, 1970, for the

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1 account of Dr. David E. Rolf at Eastman Dillon, Union
2 Securities & Co. Also there are the purchase and sales
3 confirmations for Eastman Dillon Securities & Co., trans-
4 actions for the same period for the same account.
5

6 THE COURT: Is there any duplication of what
7 has previously been marked as 12, 13 and 14 for identifica-
8 tion? These were identified as confirmations and monthly
9 statements for the period, as I understood it, May 1969
10 through February 1971, in connection with turnover rate.

11 MR. SILVERMAN: There is substantial duplication
12 between Exhibit 15 and the confirmations and monthly state-
13 ments contained in 12, 13 and 14. The statements contained
14 in 12, 13 and 14 related also to other transactions. These,
15 your Hono, relate only to Eastman Dillon transactions.

16 THE COURT: All right, proceed.

17 Q What calculation or calculations did you make,
18 Mr. Whitman, in your turnover study?

19 A There were two turnover studies, one for the
20 eight months of 1969, from May 1969 to the end of the year,
21 which was then annualized so that the turnover studies
22 were annual turnover rates.

23 The second study encompassed calendar 1970.
24 The data used were the monthly statements which were marked
25 to give an average monthly value for the portfolio.

1 Then for each period the aggregate value of
2 the purchases were totaled and for 1969 such figures of
3 aggregate purchases were annualized. In order to determine
4 a turnover rate -- in fact, I determined two for each --
5 the annual purchases were divided by the average monthly
6 value to achieve a turnover rate. In effect, this was
7 done in two ways, (1), for the total portfolio, including
8 Delanair restricted securities, and one excluding the
9 Delanair units from either market value or purchases, and
10 on this calculations annual turnover rates were obtained.
11 In addition, one other figure which was not used was
12 aggregate sales rather than aggregate purchases. The
13 turnover rate was based on aggregate purchases as related
14 to average monthly value because the aggregate purchases
15 were less in dollar amount in both years than were the
16 aggregate sales.

17
18 Q How did you treat securities that were purchased
19 in firms other than Eastman Dillon and delivered in to
20 Eastman Dillon?

21 A They were included in the monthly value -- they
22 were included in the average monthly value, but were
23 not, of course, included in the purchases.

24 THE COURT: You said earlier aggregate sales
25 was not used, only aggregate purchases was used as related

1
2 to what?

3 THE WITNESS: As related to average monthly
4 value.

5 THE COURT: Thank you.

6 Proceed.

7 Q Other than the arithmetic and the calculations
8 that you have just described, did you take into account
9 any other factors or circumstances in making a turnover
10 study?

11 A Yes.

12 Q What circumstances or factors did you take
13 into account?

14 A The factor s I took into account revolved
15 around the quality of the portfolio as measured by the
16 issues in the portfolio, in that when a portfolio is lowest
17 of the low quality, in order for such a portfolio to have
18 a chance of being economically feasible, such a portfolio
19 should be characterized by low annual turnover rates.

20 MR. TESSLER: Objection, your Honor.

21 THE COURT: Overruled.

22 Q You testified you took into account the
23 calculation you made on the quality of the securities in
24 the portfolio. Did you take into account any other
25 factors?

1
2 A No.

3 Q Did you consider whether the investor was a
4 professional in the market or an outsider?

5 A Oh, yes, I did. These turnover rates and these
6 portfolio studies are pertinent to outside passive
7 investors, as a population, and it has nothing to do, as
8 I said the last time I testified, with professional market-
9 makers or people on the inside.

10 Q What is the reason, in your opinion, that
11 the turnover study would have less significance to a market
12 professional than to an outside passive investor?

13 A The market professional doesn't suffer the
14 same impediments of very high transaction costs that the
15 outside passive investor, by definition, would be subject
16 to, and --

17 THE COURT: Why?

18 THE WITNESS: Well, in part, he doesn't pay com-
19 missions, and in greatest part, on thin market stocks
20 is not ordained that he has to sell on the bid and buy
21 on the offer. In thin market stock transaction costs can
22 be immense, your Honor, where there is large turnover
23 and it goes into one of the reasons -- this transaction
24 cost is one of the three general reasons I would give
25 as to why lowest of the low quality portfolios should be

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characterized by low annual turnover rates if they are to be economically viable.

Q Are you aware of any study or studies conducted by the Securities and Exchange Commission relating to the turnover ratio of categories of investors?

A Yes, there was, I guess, the institutional investor study that I know of, in early 1971.

Q What did that study find?

A That an average individual and personal trust accounts the turnover was approximately 20 per cent.

Q What was it in investment companies?

A Registered investment companies had an average annual turnover of 57 per cent.

Q And corporate accounts, such as pension funds?

A 23 per cent.

Q What was the annual turnover rate for 1969 as obtained by you through Exhibit 15?

MR. KELLY: I object to the question, your Honor, and to the answer as not competent and not relevant. Essentially I will return to the very foundation upon which I objected to the introduction in evidence of a series of exhibits which were a conglomerate mass of transactions drawing no distinction between those effected in the account with Eastman, those that were effected outside the account

1
2 with Eastman, and even those such as Delanair which
3 are part of the data in which the transaction was recorded,
4 in no account were any broker-dealer.

5 THE COURT: Read the question back, please.

6 (Question read.)

7 MR. KELLY: May I be heard further, your Honor?

8 THE COURT: Just a moment.

9 (Pause.)

10 THE COURT: Go ahead.

11 MR. KELLY: When we started before, your Honor,
12 there were Exhibits 12, 13 and 14 in evidence and those
13 envelopes contained --

14 THE COURT: Are they in evidence? Yes, 12,
15 13 and 14.

16 MR. KELLY: Yes, sir. Those contained all the
17 brokerage transactions in all the accounts.

18 THE COURT: If your objection is predicated on
19 that, I gather that Mr. Silverman has refined his position
20 during our interim and is now proceeding, I think, somewhat
21 differently, using a different data base.

22 Is that correct?

23 MR. SILVERMAN: In part, your Honor. As I
24 understand my obligation, it is to make available to Mr.
25 Kelly the material that the expert used in preparing his

1 opinion and since he used the material in Exhibit 15 and
2 not on material in 12, 13 and 14, I had Exhibit 15 marked
3 for identification and of course with the intent of
4 showing it to Mr. Kelly and letting him use it in prepara-
5 tion for cross or for whatever purpose he wished.
6

7 MR. KELLY: Your Honor, with respect to
8 the testimony given by the witness, he has indicated that
9 he is taking this turnover rate based upon purchases
10 made outside of the account at Eastman Dillon, in addition,
11 is taking into account the purchases of Delanair which
12 were made with no brokerage house.

13 The fact of the matter is --

14 THE COURT: He said he did it two ways, he did
15 it with Delanair included in the portfolio and then he
16 did it with Delanair excluded, and we can find out which
17 you are eliciting at this point, or was that much later?
18 But he did tell us that he included -- was the sale made by
19 other firms which passed through Eastman Dillon, or purchase

20 THE WITNES: No, your Honor, I did not
21 include any purchases or sale at other firms. I only
22 included securities in the market value that were in the
23 custody of Eastman Dillon. The purpose of that is that
24 it reduces the turnover rate and Eastman Dillon doesn't
25 get credit for the purchases which would increase the

1 turnover rate but --

2
3 THE COURT: My notes indicate, and I may have
4 written "sales" instead of "purchases" that you said that
5 sales made by other firms but passing through Blyth Eastman
6 were included in the average monthly value, but no in
7 purchases.

8 THE WITNESS: I am sorry, your Honor, I must
9 have misspoke. Securities delivered to Eastman Dillon,
10 no matter where from, so that they would be shown in the
11 month-end security position, were used in computing the
12 average monthly value. The one exception would be
13 Delanair, in one of the tests. No purchases or sales
14 any place else other than at Eastman Dillon were used in
15 any of the data.

16 THE COURT: I am afraid I am a little thick on
17 this. What is the implication of saying that no purchases
18 or sales made other than at Eastman Dillon were included?
19 What is the difference between that and saying that sales
20 made by other firms but passing through Eastman Dillon
21 were included in the average monthly value?

22 THE WITNESS: As I understood my assignment --

23 THE COURT: Can you answer the question?

24 THE WITNESS: Yes, I am -- it was to have a
25 measure of turnover --

1 THE COURT: I have to know whether my note
2 is correct and if my note is correct, that is what the
3 lawyers have heard and we have to deal with that -- sales
4 made by other firms, other than Blyth Eastman Dillon,
5 but passing through Eastman Dillon were included by you
6 in calculating average monthly value, correct?
7

8 THE WITNESS: No, that is not correct. Pur-
9 chases made at other firms and delivered to Eastman Dillon
10 would be included in average monthly value.

11 THE COURT: All right, I have cleared that up.
12 Frame your question again.

13 MR. SILVERMAN: And perhaps I can go back a
14 few steps, your Honor.

15 Q In calculating the purchases, the aggregate
16 purchases for the eight-month period in 1969, did you
17 include purchases made in firms other than Eastman Dillon?

18 A No.

19 Q In calculating the average monthly value into
20 which you would divide the aggregate purchases, did you
21 include purchases made outside Eastman Dillon where the
22 securities were delivered into Eastman Dillon?

23 A Yes.

24 Q What was your reason for including such pur-
25 chases?

1 A As I understood my engagement, it was to
2
3 determine turnover rates based on the securities in the
4 custody of Eastman Dillon.

5 Q Could you give us an example, in round numbers,
6 as to how you determined turnover rate?

7 THE COURT: Move to your key question, please.

8 Q What did your study reveal as to the turnover
9 rate in 1969, without including Delanair?

10 A The turnover rate was --

11 MR. KELLY: I object to this question, your
12 Honor.

13 THE COURT: Overruled.

14 A The turnover rate was 185 per cent.

15 Q What was the turnover rate including Delanair?

16 A 202 per cent.

17 Q And that is giving a value to Delanair?

18 A It is giving a value to Delanair, yes, at
19 cost, initially, and then at market without reference to
20 its redirection.

21 Q Did your documents reflect Delanair was held
22 in the account of Eastman Dillon?

23 A It was held at EastmanDillon in the account of
24 Dr.Rolf.

25 Q Was your turnover rate an annual rate?

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A Yes.

Q Both instances were annual turnover?

A Yes.

Q What was the turnover rate for calendar year 1970?

A Exclusive of Delanair, 163 per cent, and including Delanair, 102 per cent.

Q When you say "including Delanair," did you include it as a purchase or in your calculation of monthly value?

A No, just in the calculation of monthly value for 1970.

Q To the extent you included Delanair, the turnover rate was less than if you had not included it?

A That is correct, for 1970.

Q Do you have an opinion as to whether the turnover rate, the annual turnover rate for 1969, as determined by you under all the circumstances, was excessive?

MR. KELLY: I object to the question, your Honor.

THE COURT: Overruled.

A In my opinion, it was.

MR. TESSLER: May I be heard, your Honor?

THE COURT: Yes.

MR. TESSLER: We heard turnover rate discussed

1 here for the last half hour and your Honor overruled a
2 question respecting Mr. Whitman's opinion that the quality
3 of the portfolio -- the turnover rate of a portfolio
4 containing lowest of the low, in his opinion, should
5 have a lesser turnover rate than some average turnover rate
6 which we have not heard about -- we have gotten statistics
7 as to private accounts, registered investment companies,
8 corporate pensions, etc., but I must make the objection
9 because I think the assumption coming across here is that
10 Dr. Rolf had a portfolio that consisted of, to use Mr.
11 Whitman's term, lowest of the low quality stock, and that
12 assumption was gathered from the fact that when Mr. Whitman
13 appeared two weeks ago he said 15 of the stocks in the port-
14 folio, which he named specifically, were in his opinion
15 lowest of the low quality stocks, but, your Honor, it
16 is clear from the evidence, and I specifically refer to
17 Exhibit 8, 9 and 10, that Dr. Rolf's portfolio consisted
18 of much more than the 15 stocks Mr. Whitman has referred to.

19 THE COURT: Bring that out on your cross.

20 MR. SILVERMAN: Could the reporter read the
21 question, your Honor?

22 THE COURT: He answered that he considered the
23 turnover rate for 1969 to be excessive.

24 Q What was the basis of your opinion that it was
25

excessive?

A Under the circumstances, where a portfolio consists in great measure of lowest of low quality securities it is my opinion a turnover rate should be below average if the portfolio is to be economically viable.

There are three general reasons for this. Lowest of the low quality securities are businesses whose operations and resources to prove out would have to be something dramatically improved over time.

For example, if Xerox at one time would have been lowest of the low quality, whether it was an idea or an invention, for those types of securities to be economical viable, one has to hope for very large capital gains, five times over, 10 times over, something that is generally a time-consuming process while the business develops, the business as a business.

Second, transaction costs in lowest of the low quality stock tend to be huge. That goes in part to the economics but much more the spread between bid and asked and the expense to which outside passive investors are then subject. Trading costs in these types of portfolios can eat up capital relatively rapidly.

Finally, much trading that is done and should be done is done on information. One of the characteristics as I pointed out when I was here before, about lowest of

1 rmb Whitman-direct 395

2 the low quality securities that there is an absence of
3 information in the market on which trading activity
4 should take place. It is for those reasons that I
5 think under these circumstances the portfolios that existed
6 here at the end of these monthly periods were those that
7 would lead me to conclude that the trading in Dr. Rolf's
8 account was excessive.

9 THE COURT: When you say much trading that is
10 done or should be done is done on information, you mean that
11 if the shares fall in the category of what you call lowest
12 of the low securities, there is apt to be less information
13 available to the outside investor, is that your point?

14 THE WITNESS: Yes, your Honor. I point out
15 last week that on many of these securities there was nothing
16 published about them, some were not even filing companies
17 with the Securities and Exchange Commission.

18 THE COURT: We will take a few minutes recess.

19 (Recess.)

20 BY MR. SILVERMAN:

21 Q Mr. Whitman, you testified that for the eight-
22 month period in 1969, you made two turnover studies, one
23 with Delanair in and one without Delanair in. Is your
24 opinion that the trading on an annualized basis for 1969
25 was excessive based upon the study of Delanair being in

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1 or out or on both of them?

2 A On both of them.

3 Q So that if we were to exclude Delanair com-
4 pletely from the picture in 1969, it would be your opinion,
5 would it not, that the trading was excessive based upon
6 the annual rate you computed?
7

8 A Yes, and I think it would be probably more
9 appropriate to exclude them, in all respects.

10 Q In 1969 do you have an opinion as to whether
11 the turnover rate in 1969 was excessive?

12 A Yes, it was.

13 Q Including or excluding Delanair --

14 THE COURT: 1969?

15 Q I am sorry, 1970.

16 A Yes, in 1970, including or excluding Delanair.

17 Q What is your opinion on whether or not it was
18 excessive?

19 A It was excessive.

20 Q Also the basis of your opinion for 1970
21 that the turnover ratio as determined by you is excessive
22 the same as your testimony was for 1969?

23 A Yes, under the circumstances it was excessive.

24 Q Did you Mark to market the securities on
25 hand in Eastman Dillon's account for the year-end

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or for the month ended December 31, 1970?

A Yes.

Q How did you go about marking the securities on hand for that month?

A Well, I had my assistant price the securities from the monthly statements. The prices were taken from Note Quotation Bureau Bank and Quotation Chronicle -- Commercial and Financial Chronicle, Banking Quotation Record

Q Did you use the monthly statement for December 31, 1970?

A Yes.

Q Then you priced each security listed in that statement?

A That is correct.

Q Did you make any adjustments or allowances in your evaluation?

A Yes, again on Delanair.

Q What adjustment or allowance did you make?

A Well, either include Delanair at its mark, as if it were a marketable securities, or exclude it completely as a security of which there was no realizable value at the time.

Q Based upon the first approach, including Delanair as a marketable security, as though it could be

traded, what was the value of the portfolio as reflected in Eastman Dillon's monthly statement for December 31, 1970?

A Approximately \$255,000.

Q Is that including Delanair as a marketable security?

A Yes.

Q Excluding Delanair as a marketable security
what was the value?

A Approximately \$130,000.

Q Did you also mark to market the securities on hand in Eastman Dillon as of March 31, 1971?

A Yes, March 28, 1971.

Q Did you use the same tools in marking it to market?

A Yes.

Q What value did you reach including Delanair?

A That is as of March 28, 1971, and the net position, including Delanair would have a value of approximately \$428,000 and the net position exclusive of Delanair would be approximately \$218,000.

Q The last time you appeared I noticed you were reading from notes and a schedule. Would you describe for us the schedule and notes that you were using in your

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1 testimony, and that would be when you were testifying as
2 to the quality of securities?

3
4 A I believe you are referring to two schedules
5 I made up. The first one is entitled "Quality of the
6 Issuer, Objective Standards," and is entitled "David E.
7 Rolf New Securities Purchased May 1, 1969 to March 31,
8 1971."

9 The second schedule is extracted from the first
10 and entitled "Lowest of Low, Dr. David Rolf Security Purchase
11 May 1, 1969 to March 31, 1971." These schedules I am
12 reading from are a compilation of the various factors I
13 had used as to size of business, seasoning of business,
14 seasoning of the security, earnings record, dividend
15 record, trading information and access to published informa-
16 tion, which I used to classify securities as either high
17 quality, low quality, lowest of low, and "Comment."

18 Q I show you what has been marked as Plaintiff's
19 Exhibits 16 and 17 for identification, and I ask you if
20 Exhibits 16 and 17 are copies of the schedules and work
21 sheets you have just described?

22 A Yes, they are.

23 MR. SILVERMAN: Your Honor, I offer Plaintiff's
24 Exhibits 16 and 17 in evidence.

25 MR. KELLY: No objection.

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MR. TESSLER: I assume these are being offered only as the information the witness used in reaching his conclusion and not for any objective purpose.

MR. SILVERMAN: That is so, your Honor.

I am making available the material he used so that they can study it and question him on it and the like.

MR. TESSLER: No objection.

xxx

(Plaintiff's Exhibits 16 and 17 were received in evidence.)

MR. SILVERMAN: Thank you, Mr. Whitman.

Your witness, Mr. Kelly.

CROSS-EXAMINATION

BY MR. KELLY:

Q Mr. Whitman, am I correct in understanding that the base on which the compilation was made is Exhibit 15, the month statements and confirmations of Eastman Dillor

A Yes, I believe so.

Q Was this the same turnover study you talked about when you were last here?

A We are talking about the turnover study?

Q Yes.

A Essentially, yes; specifically, no.

Q Tell me the respects in which the study that

1
2 you testified to when last you were here is different
3 than the study that you are speaking of now?

4 MR.SILVERMAN: Your Honor, I object. He
5 didn't testify to a turnover study. He had just begun his
6 testimony as to a turnover study.

7 THE COURT: I think it probably lends itself to
8 a simple answer and since we started down that road, I
9 will allow that answer.

10 You may answer.

11 A The last time here I had these studies (indicat-
12 ing), as well as studies about purchases elsewhere, which
13 I then chose to disregard, "elsewhere" being outside
14 Eastman Dillon. Specifically, at the last time, in doing
15 a turnover study I relied only on purchases to determine
16 annual turnover rates. My reason for that was it was the
17 recommended method of computation as contained in an article
18 on churning in the Harvard Law Review.

19 Subsequently, after I got off the stand, I
20 said to myself that I believed that as part of N1(r), all
21 investment companies report turnover rates and that I had
22 better look at the rules and regulations pertaining to
23 the 1940 Investment Act to see how turnover rate is determin
24 for investment companies.

25 I did that, and the SEC rules under the 1940

2 Act differed from the Harvard Law Review article in that
3 the SEC said (1), you take the lesser of aggregate pur-
4 chases or aggregate sales and apply that to an average
5 monthly value to determine a turnover rate.

6 I then took the confirmations to ascertain
7 that it was proper to have used purchases, which I did,
8 rather than sales.

9 Q Well, help me in this respect: There was a
10 turnover study you had the last time?

11 A Yes, sir.

12 Q Could I see it?

13 A I don't have it.

14 Q You have a turnover study that you brought
15 this time?

16 A Yes.

17 Q Could I see that?

18 A Well, these are the same things I had last
19 time --

20 Q These are the new ones?

21 A These are the new ones and the old ones I
22 have not really changed anything except I believe I may
23 have had another piece of paper with these calculations,
24 but the raw data has not changed.

25 Q That is what I am trying to find out.

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1 MR. SILVERMAN: Your Honor, I believe if
2
3 he is going to take documents from the witness he should
4 have them marked.

5 THE COURT: Yes.

6 (Defendants' Exhibits SS and TT were marked
7 for identification.)

8 Q You said last time that the preparation of the
9 schedule was done by an associate or assistant of yours.

10 A That is correct.

11 Q Is that true as to these documents that I have
12 here that have just been marked?

13 A As to the green paper, yes --

14 THE COURT: That is marked?

15 Q In other words, both green papers, SS and TT,
16 were the documents that were prepared by someone else?

17 A One of my graduate students, yes.

18 Q That was the turnover study that you talked
19 about the last time, correct?

20 A Yes, plus there were other sheets, other
21 yellow paper, with other houses.

22 Q The last time you said that the source material
23 for the turnover study were those exhibits that included
24 the brokerage transaction outside of Eastman Dillon?

25 A Yes.

xxx

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2 MR. SILVERMAN: I object. Where is he reading
3 from, your Honor?

4 MR. KELLY: Let me read it, then.

5 Q Let me ask you if you were asked these questions
6 the last time --

7 MR. SILVERMAN: Your Honor, may I ask that Mr.
8 Kelly tell the page and line and maybe we can save reading.

9 Q Page 210, line 12:

10 "Q Mr. Whitman, at my request and acting under
11 your direction, to the best of your knowledge were broker-
12 age statements, confirmation and monthly statements reviewed
13 to determine the brokerage statements and monthly confirma-
14 tion statements in Dr. Rolf's account reviewed to determine
15 the turnover rate in that account during the period May
16 1, 1969 through March 31, 1971?"

17 MR. SILVERMAN: I withdraw my objection, your
18 Honor.

19 Q The source material, as I understood it, were
20 all the brokerage statements of all of the brokerage firms
21 from which this turnover chart was prepared, am I wrong?

22 A You have me confused. Last time there was
23 other material with purchases at other brokerage houses.

24 Q Correct.

25 A This material now includes only monthly posi-

tions at Eastman Dillon and purchase transactions at Eastman Dillon with the one aberration of the restricted shares of Delanair.

Q You mean SS and TT?

A Yes.

Q So these were not the ones that you talked about before that were prepared by your assistant?

A I believe yes, they were, and there were additional green sheets with purchases. I don't think those were changed since last week.

Q What I am trying to ascertain is this: If I understood you last week you said the source material for these were all the brokerage statements, both of Eastman Dillon and others. Did you not say that the last time?

A I don't know what you mean by "these." The source material for what I had --

Q SS and TT.

A No, sir.

Q You did not say that?

A SS and TT refers only to Eastman Dillon.

Q Do you recognize that document (handing)?

THE COURT: Showing the witness.

A Yes.

MR. KELLY: May I have it marked for identi-

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1 rmb Whitman-cross 406
2 fication, your Honor?

3 THE COURT: Yes.

4 Showing the witness UU for identification.

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5 (Defendants' Exhibit Uu was marked for
6 identification.)

7 MR. SILVERMAN: May I see that, Mr. Kelly,
8 please?

9 MR. KELLY: Yes.

10 (Pause.)

11 Q Is this document, UU, the source material for
12 the turnover study?

13 A No.

14 Q What is it?

15 A Those materials that I prepared, I guess
16 about two years ago, in connection with reviewing various
17 portfolios --

18 THE COURT: Of Dr. Rolf?

19 THE WITNESS: Yes. I think it was about two
20 years ago, it may have been 18 months ago.

21 Q I call your attention to page 5 of that document.
22 Did you write the word "omit" in there?

23 A That is my writing.

24 THE COURT: Omit, o-m-i-t?

25 MR. KELLY: Yes, sir.

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2 Q Can you explain to me what was the reason for
3 your writing in the word "omit" adjacent to the purchases
4 of Monarch Industries?

5 A As I say, I prepared this some -- let me say --
6 two says ago. I would not be sure of all the purposes
7 for which I prepared this thing labeled "June '69,
8 Buy and Sell Transactions" and at this date there is no
9 way I would have said "omit." I don't think I could
10 meaningfully respond.

11 Q Might it have been because you were aware of
12 the fact that those transactions were not effected in the
13 account of Blyth Eastman Dillon?

14 A If the purchases were in another house?

15 Q Yes.

16 A That would be my speculation, but I really
17 don't know.

18 Q As an expert wouldn't you consider it reasonable
19 in studying a brokerage account of a brokerage firm for
20 churning to eliminate transactions which did not occur in
21 that account?

22 A Yes, sir, it certainly would -- the transaction
23 did not occur at that house?

24 Q Right.

25 A I certainly would exclude them.

1
2 Q If those securities were delivered into that
3 house either free or against payment, would you include
4 those transactions in determining whether there was churn-
5 ing?

6 A No, sir, I would not include the purchase.
7 I would, to reduce the level of turnover, include it in
8 the average monthly value under the theory that when it
9 is at the brokerage house it is under the control of the bro-
10 erage house.

11 The purchases at some other house are excluded,
12 the value of the securities held in position at that house
13 are included.

14 Q What happens if the securities are delivered
15 out?

16 A The average value goes down and there are no
17 purchases. The brokerage house at that time doesn't
18 have that average value with which to calculate a turnover
19 and I would suppose you properly exclude the -- I would.

20 Q In making your calculations can you explain
21 what you did with respect to the three hundred and forty
22 some-odd thousand dollars in money that went out of
23 the account?

24 A Basically I excluded it in the test that had
25 nothing to do with Delanair -- excluded any purchases

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of Delanair, excluded it from value when any calculations were made for 1969 or 1970, exclusive of Delanair.

Q Let's start on a simple basis. You did what you did each month, for a given month?

A I did what I did for each month as it refers to marking to market, an average monthly value.

Q No, in your computation for turnover study is it not a fact that you annualized the account as it stood on each month?

A As to value.

Q And as to transactions, purchases and sales?

A Those are just aggregated for the period -- aggregated and annualized, Mr. Kelly.

Q Then I don't understand all this. What I would like to do is to determine what you did to reach your computations and recognizing that you ended up with an annualized result, did you do what you did for each month, namely, take a look at the account, determine the inventory, the purchases and the sales and the value?

A No. At each month I just determined the value. If your question is directed towards what you do for each month, you determine the market value, the inventory, as you say.

Q Let's put it that way, then: You looked at

2 a given month and you said, "What is the value of the
3 securities held in that account at this time," right?

4 A Yes.

5 Q That is all you did for that month?

6 A Yes.

7 Q The following month you put again a market
8 value on the securities, as a market price prevailed at
9 that next month?

10 A Yes.

11 Q When you got through you had a value at the end
12 of the year?

13 A Yes.

14 Q This is all now market value of securities
15 held, right?

16 A Yes, plus credit balance, minus debit balance.

17 Q Let's take them one at a time. I understand
18 what you told me about market value. What next did you
19 do?

20 A I took all the purchases during the relevant
21 period and totaled the dollar amount.

22 Q The total number of purchases in the year?

23 A Yes.

24 Q According to the purchase price?

25 A Yes.

Q What next did you do?

A At Eastman Dillon. Those were just done, purchase price for the securities, taken from the confirmation-

Q In other words, you took out of the confirmations and monthly statements of Eastman the total amount of securities purchased in that account and calculated the total cost to buy those securities?

A That is correct.

Q You had the market value and you had the total costs?

A Yes.

Q What did you do with those two numbers, or what else did you do?

A Let us say for 1970 the market value was averaged, total 12 average monthly values and then divided by 12 --

Q Do you need --

A I can just read the actual numbers. In 1970 -- well, I won't read each month, but in January the value of the portfolio exclusive of Delanair was 360,000; in November 170,000; and therefore, for the 12 months we came to \$199,583.

Q Is that the average --

A Monthly value. It ranged from a high of

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\$364,000 to a low of \$130,000.

Q Which, I take it, reflected a decline in the market?

A That's correct -- decline in the value of the portfolio. I don't know what happened to the market.

Q If the market had gone up, your whole turnover rate would be different?

A If the market for the securities had gone up, yes.

Q You know perfectly well that the entire market went down during the period of time you were making this study, don't you?

MR. SILVERMAN: I object, your Honor.

THE COURT: No, I will allow it.

Is that so, sir?

THE WITNESS: General market? I would only be speculating. I don't know.

Q Would you recognize as reasonable measure of a marketplace the Dow Jones and the Standard & Poor's index?

A Either of them; yes, I would.

Q Would those two documents help you in respect of what was occurring in this period of time with respect to securities in the marketplace?

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MR. SILVERMAN: I object, your Honor. They

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should be marked, should be authenticated.

4

THE COURT: Let's mark them.

5

MR. SILVERMAN: It should be authenticated.

6

What are those two pieces of paper?

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MR. KELLY: They are two pieces of paper, at

8

this point.

xxx

9

(Defendants' Exhibits WW and XX were marked

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for identification.)

11

THE COURT: Are these being used merely to

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refresh the witness' memory?

13

MR. KELLY: I may offer them, your Honor. I

14

suspect he will authenticate the correctness of these charts

15

THE COURT: Let me know the outstanding question

16

please?

17

MR. KELLY: The question was, does the witness

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recognize these documents as respects stock averages as

19

being valid measures of stock movement?

20

THE WITNESS: Yes, I do.

21

THE COURT: Valid measures of stock what?

22

MR. KELLY: Movement.

23

THE COURT: First let's consider the

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question as meaning does he recognize the two publishers

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of the documents as publishing that type of data, and the

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2 answer, I gather, is yes, correct?

3 THE WITNESS: Yes.

4 THE COURT: The next question is whether
5 WW and XX are shown to the witness to refresh his recollec-
6 tion about the period in question or for some other
7 purpose?

8 MR. KELLY: They are being offered to authenticat
9 them as admissible in evidence and from which I will
10 examine the witness with respect to the conclusions to
11 be drawn from them.

12 THE COURT: All right, proceed.

13 Q Do you recognize those documents as authentic
14 copies of the two indexes?

15 A I guess the answer is yes. They are from a
16 third source --

17 MR. SILVERMAN: I object. He is not being asked
18 to guess. He is being asked whether he recognizes those
19 documents as a Standard & Poor's index and a Dow Jones
20 index.

21 THE COURT: What is your answer to that, sir?

22 THE WITNESS: I can only recognize them as
23 somebody's reprint.

24 THE COURT: Of? We are not concerned that
25 they are photocopies.

1 THE WITNESS: I don't mean that, your Honor.
2
3 I do have other sources, like Standard & Poor's --

4 Q Will you bring them back this afternoon?

5 A Yes, I will.

6 THE COURT: Why don't you show them to counsel
7 and perhaps we can get past this.

8 THE WITNESS: As far as I know, they are okay.

9 THE COURT: If you will pose a stipulation
10 to counsel, let's see if Mr. Silverman can agree.

11 MR. KELLY: That these are authentic copies of
12 the Dow Jones and Standard & Poor indexes for the period
13 including the two years in question, 1969, 1970, and part
14 of 1971.

15 MR. SILVERMAN: Your Honor, may I ask the wit-
16 ness a question on voir dire?

17 THE COURT: Yes.

18 VOIR DIRE EXAMINATION

19 BY MR. SILVERMAN:

20 Q Do you recognize Defendants' Exhibits XX and
21 WW to be photocopies of standard material which you have
22 in your files and office and which you use?

23 A Yes. I have no reason to think they are not
24 authentic. I cannot authenticate them because they are
25 reprints.

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2 MR. SILVERMAN: If Mr. Kelly tells you they
3 are from the book, I will stipulate they are authentic.

4 MR. KELLY: I do so tell you. I offer them.

5 THE COURT: You can state you have no objec-
6 tion and you have until after lunch hour to check them
7 out, if you wish.

8 MR. SILVERMAN: That is fair.

xxx

9 (Defendants' Exhibits WW and XX were
10 received in evidence.)

11 BY MR. KELLY:

12 Q Can you tell me from those what the approximate
13 index number on April 1969 was of the Standard & Poor's
14 stock index?

15 A Which Standard & Poor's index?

16 Q Use the 4/25.

17 A Can I have the question again?

18 Q What was the index number in April of 1969?

19 A It reached a low of 75.58, and a high of almost
20 90. I am unable to read the exact number.

21 Q You are saying that is in a --

22 A No, no, I take it back. This is very hard to
23 read, but the fourth month should be -- it would be almost
24 90 for the low -- I think I was reading May to you -- I
25 guess almost 96 for the high. I could bring the actual

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Whitman-cross

2 numbers back.

3 THE COURT: It is time for recess --

4 MR. KELLY: Could I just put the question, your
5 Honor, so the witness can answer it?

6 Q With respect to the two indexes, Standard &
7 Poor's, and the Dow Jones, the index, as they existed in
8 April of 1969 and the condition under which they existed
9 in March of 1971 --

10 A Right.

11 Q And whether or not, in fact, there was not in
12 that period of time a continuous market decline. I am
13 perfectly willing to accept that from any books you have.

14 A Standard & Poor's?

15 Q No problem.

16 THE COURT: We will recess for lunch until
17 two o'clock.

18 (Luncheon recess.)

19 -----

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AFTERNOON SESSION
2:00 P.M.

JA 282

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3 M A R T I N J. W H I T M A N resumed.

4 CROSS-EXAMINATION (continued)

5 BY MR. KELLY:

6 Q Mr. Whitman, I show you Exhibit T --

7 MR. SILVERMAN: Your Honor, I thought at the
8 luncheon recess we would look at the Standard & Poor's and
9 Down Jones and get testimony on that.

10 MR. KELLY: I will get to that.

11 THE COURT: Was that T or TT?

12 MR. KELLY: I am sorry, that is TT, your Honor.

13 Q Am I correct in saying that with respect to
14 that exhibit you used for your turnover rate that the
15 fact is that during the year 1969 the actual purchases
16 made in the account in that year totaled \$835,586?

17 A Yes.

18 Q Those were securities during the entire year
19 1969 that were bought for money in that account?

20 A No.

21 Q Would the statement I just made be correct if
22 I said excluding Delanair?

23 A No.

24 Q Where am I wrong?

25 A It is only from May through December. I

1 don't have anything on what went on in the account --

2 Q You know the account only opened with Yamada
3 in May, correct?
4

5 MR. SILVERMAN: Objection. He is examining
6 a witness as to a particular period that the witness testi-
7 fied to, May 1, 1969 through December 30, 1969, and I think
8 he should keep his cross to that period, your Honor, or
9 else run the risk of making this witness his witness, to
10 the extent he goes outside that period. The witness
11 testified May 1st.

12 THE COURT: Overruled.

13 Q Let me put it this way and see if I am right:
14 If you exclude Delanair for the period of May 1st to the
15 end of the year, the actual purchases in fact amounted to
16 \$835,586?

17 MR. SILVERMAN: If he knows, your Honor. Again,
18 I object, your Honor.

19 THE COURT: If we are going to make references
20 to the sheet, TT so far is only marked for identification.

21 MR. KELLY: I will offer it in evidence, your
22 Honor.

23 THE COURT: Any objection?

24 MR. SILVERMAN: No objection.

25 THE COURT: Received.

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(Defendants' Exhibit TT was received in evidence.)

Q In making your turnover computation, did you use the figure for purchases made in the period you covered \$835,586?

A Yes.

Q Did you for purchases in the year 1969 use the figure \$1,253,379?

A For annualized purchases in 1969 I used the figure 1,253,379.

Q In other words, one of the elements in your turnover computation was the figure \$1,253,379?

A Yes.

Q That doesn't represent actual purchases, does it?

A No.

Q It doesn't represent any tranction at all, that number, does it, above the \$835,586?

A Of course it does, it represents \$835,586 of purchases for eight months,extrapolatioed to an annual basis or a 12-month basis.

Q What is the supposition on which you used an average for a fictitious period of three moths?

A I don't know how one can meaningfully compute

1 turnover rates unless there is reference to a time period.
2 The conventional periods used, whether in the SEC investor
3 study or N(1)(r) or the Harvard study or anything else
4 I have ever seen are annual rates of turnover.
5

6 Q If in reality for the fictitious three months
7 there had been no purchases, your results would have been
8 different?

9 THE COURT: Four months.

10 A Four months. Had there been no purchases in
11 those four months, the results would have been different.

12 MR. SILVERMAN: I object again. We are con-
13 cerned with the period when Mr. Yamada and Mr. Stott were
14 handling the account. We are not concerned with the earlier
15 period.

16 MR. KELLY: I am not talking about the earlier
17 period.

18 THE COURT: But for the fact that it is customar
19 to translate these calculations into annual rates, if you
20 had chosen to could you not have calculated the turnover
21 rate for the period May 1 through the end of December 1969,
22 using seven-twelfths as the period of seven months -- using
23 using months as the period? You could have translated
24 it into seven-twelfths of the year or monthly turnover if
25 you had to do it, could you not?

2 THE WITNESS: Your Honor, to make it meaningful,
3 I then would have to go to the SEC statistics,
4 the investor study, and do the same thing.

5 THE COURT: It is possible.

6 THE WITNESS: Yes, but I don't know that it
7 has any meaning. It is possible.

8 THE COURT: So impliedly, Mr. Kelly, I think the
9 witness concedes that for those first few months of 1969
10 he is not saying there were transactions but, rather, if
11 you spread it, or as he called it, annualize it, this is
12 what you come up with.

13 MR. KELLY: I make only the point your Honor
14 that is it supposed transactions in the supposed four months
15 ample with respect to the other eight, and that may or
16 may not be true.

17 THE COURT: Of interest would be whether
18 7/12 comes out with the same result, mor or less -- 8/12,
19 rather.

20 Q Am I correct in understanding that with respect
21 to your figure of 185 per cent, which was one of your turn-
22 over rates, that that means that the account was turned
23 over less than twice in one year?

24 A Yes.

25 Q The figure 185 per cent could also be said to be

1 rmb Whitman-cross

2 the equivalent of 1.85, correct?

3 A Yes.

4 Q Or, in other words, that the turnover was 1.85
5 times?

6 A Yes.

7 Q Would you consider that an abnormal turnover
8 rate for an account that was a speculative account?

9 A Under the circumstances where they were concen-
10 trating the lowest of the low, yes.

11 Q I am assuming merely a speculative account, if
12 I can fairly use that term as meaningful to you.

13 MR. SILVERMAN: Your Honor, I object.

14 THE COURT: I think he is entitled to put his
15 own questions to the witness. It would be very nice if
16 he did it all in accordance with your framework, but
17 he has his own right to pursue the matter as he wishes.

18 MR. SILVERMAN: Of course, but if the witness
19 testifies that he took into account several factors and
20 then on cross-examination he is asked, "Can you limit your-
21 self to this one factor and tell me whether it is specu-
22 lative" --

23 THE COURT: He is the expert and he can answer
24 yes or no. He can say what he can and can't do, and what
25 would happen if he used different criteria.

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2 MR. SILVERMAN: Then I don't understand the
3 question and perhaps maybe the witness doesn't understand
4 it.

5 THE COURT: He has not said so. If you wish
6 it repeated, we will have it repeated.

7 MR. SILVERMAN: I would appreciate that, Judge.

8 THE COURT: Can you state it again or do you
9 want it read back?

10 MR. KELLY: I would like to have it read back,
11 your Honor.

12 (Question read.)

13 A I can visualize -- I mean I do visualize easily
14 circumstances in which that turnover rate would not be
15 abnormal in a speculative account. For example, suppose
16 some outside passive investor, which is what we are talking
17 about, invested in U.S. Government bonds on 95 per cent
18 margin, the quality issue there is very high and I could
19 very easily see an economic justification for a high
20 turnover rate in an account like that which I would classify
21 as speculative.

22 Q Let's take an account in which an investor
23 put up \$100,000 with the objective of doubling his money
24 in one year, would you consider such a turnover rate
25 abnormal for that kind of account and that kind of an

investment?

A Yes, I would, if that account were trying to invest in losses of the low-quality securities and had a concentration there.

Q Let's suppose he was not investing in the lowest of the low, but something else, but investing on a speculative basis. Then would you consider that rate abnormal?

A That would depend -- you would run the range for other elements besides quality of the issuer. As I answered before, where you put in a consideration of the speculation arising out of the financial position of the holder and the holder is investing in very high quality securities, I would think that under those conditions a trading account with that rate of turnover could conceivably be all right under those circumstances.

Q It would depend upon the objectives of the investment you are saying?

A No.

Q You would not consider the objective of the investor in connection with the judgment as to whether a turnover rate was high or low?

A There are a lot of ways investors can achieve objectives.

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Q I asked you merely do you take into account the objectives of the investor in reaching a determination as to whether or not a turnover is high or low?

A Frequently, no.

Q How about the infrequent instances?

A I would say the infrequent instances probably tend to be weighted toward an account that is heavily borrowing to try to make money in classes of securities that are high-grade, where there is a flow of information and where there are very, very good markets where one can trade in and out.

Q Have you ever heard of an investor speculating and not involving himself in high-grade or blue chip securities?

A Would you repeat the question again?

Q Are you acquainted with investors who are investing for speculative purposes who invest in securities other than high-grade, blue chip securities?

A Yes.

Q Do you contemplate such investors who might involve themselves in over-the-counter securities?

A Yes.

Q Assuming whatever the lowest of the low is that none of those are bought, would you consider such an

investor who is seeking to double his money in one year creating a turnover rate higher than two times?

A I am sorry, could you postulate it again?

THE COURT: Do you want it read back or reframed?

THE WITNESS:Reframed, if you don't mind.

Q Let us assume an investor who is involved in speculating, whose objective is to double his money in one year and who is not in buying lowest of the low or highest of the high, whatever that means, and if there were such an investor with that objective in mind, would you consider a turnover rate exceeding two times as excessive?

A Yes, I think the norms were brought out in the institutional investors study and are about in the ballpark I would know about.

Q This institutional investor, that is the person you would consider a speculative investor?

A Many of them are.

Q What?

A Many of them are.

Q And you would say that, by and large, if you examine their portfolios, you would not find turnover rates of 1.85 or higher?

A I think you would find what the SEC study showed you would find.

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Q If you deleted the securities purchased outside the Eastman Dillon account from your monthly portfolio average, do you know what the turnover rate would then be?

A Much higher than I calculated it.

Q In your calculations, which were the calculations without Delanair -- that is the one I am talking about now -- did you take into account that Dr. Rolf withdrew from the account \$340,000?

A Yes.

Q Will you tell me, in the portfolio method that you used, the manner in which the 340,000 withdrawn from the account was dealt with?

A The market value of the portfolio was computed each month, to which was added credit balances and from which was deducted debit balances. When the 340,000 was removed from the account in mid-1969, the month in which it was removed, the value of the account was less by \$340,000 than it would have been had the \$340,000 remained in the account.

Q Explain this to me: If I started with \$100,000 in security values and during the course of the year I took out \$50,000 and nothing happened for the balance of the year, what turnover rate has there been in my account?

A I can't answer just on that set of facts.

1 Q Why can't you?

2 A Because a turnover rate is related to the
3 aggregate purchases during the period related to the average
4 monthly value of the account. I don't gather from
5 what you told me that you put in the aggregate amount of pur
6 chases.
7

8 Q I started with 100,000 on January 1 and during
9 the year I took out \$50,000 and at the end of the year what
10 was my turnover rate?

11 A It is not calculable.

12 Q Isn't it zero, there was no turnover?

13 A I don't know what the purchases and sales were.

14 Q I told you everything about the account.

15 A There was no transactions in the account -- no
16 purchases or sales transactions in the account?

17 Q That is correct.

18 A Then the turnover rate would be zero.

19 Q Dr.Rolf took out \$340,000. Do you not take
20 that amount of money and deduct it from his opening inventor

21 A No.

22 Q In your sheets that setup the system whereby
23 you reached your calculations, will you show me an entry
24 reflecting \$340,000?

25 A I think you have the sheets.

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Q I think you do.

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A No, sir, I have only the purchase. There is
a value sheet.

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Q Right (handing).

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THE COURT: Showing the witness?

7

MR. KELLY: Exhibit SS.

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A Here in September, \$340,000, taken out, so
that the value becomes \$435,000 instead of \$775,000 (in-
dicating).

11

Q I thought the column that reflects --

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A This reflects the value exclusive of Delanair.
The 775,000 would reflect a value including Delanair.
This of course is not taken out at the opening, but rather
when the \$340,000 actually comes out of the account, which
I see from this should have been September 1969.

17

18

Q You mean that the Delanair was given a value
of \$340,000 by you in your computations?

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A No, sir, not at this point. It had a cost
basis of \$340,000. When the value was calculated ex-
Delanair, the most significant test, obviously Delanair
was given no value.

23

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Q Take the one with Delanair. You gave
Delanair \$340,000 in value?

25

A At the time it was purchased.

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Q Right.

A And including Delanair, Delanair was given a value of its cost basis to Dr. Rolf. Subsequently there- to, insofar as there were valuations of Delanair included, they were not cost valuations but market valuations.

Q Forget the succeeding values and take the 340,000 at the time it was first put down there, okay?

A Yes.

Q Take your calculations without Delanair, and Delanair is not in the case, what happens to the 340,000?

A It is not in the value.

Q It isn't taken into account in your figures?

A Of course not. It isn't there.

Q The \$340,000 went out of the account and in your calculations it made no change?

A No, sir. If \$340,000 had been in the account, the value of the account would have been \$775,000, not \$435,000.

Q In the 340 you just told me about, you ascribed the value of \$340,000 to Delanair coming into the account, correct?

A No, it is not correct for the account as calculated exclusive of Delanair, but it is --

Q Let's just talk about Delanair. We will

1
2 come to that.

3 A I am sorry, I don't understand the question?

4 Q In your monthly valuation did there come a
5 point where you put a value of \$340,000 on Delanair stock
6 coming into the account?

7 A I have to ask you which valuation?

8 Q Take the monthly valuation.

9 A Which monthly valuation?

10 Q Whenever you first put in 340,000.

11 A Mr. Kelly, I did two monthly evaluations.

12 THE COURT: You did it with and without?

13 THE WITNESS: Yes.

14 THE COURT: You have to know which one counsel
15 is talking about.

16 Q The one with Delanair.

17 A \$775,000. In September, Delanair, at the time
18 it was purchased, was valued at cost.

19 Q When you used your computations without
20 Delanair, how did you deal with the \$340,000?

21 A I removed it from the valuation.

22 Q So there is a month in which I can find
23 that the valuation figures of the stock include a deduction
24 of \$340,000 in cash?

25 A That is correct.

1
2 Q Can you tell me the month in which that was
3 done?

4 A The summary sheet shows it is September of --

5 Q September of 1969?

6 A -- 1969.

7 Q The 9600 shares of Monarch that came into the
8 account, did you place a value on those shares coming into
9 the account?

10 A Yes.

11 Q Do you know what value you placed on them?

12 A Here I have -- let me read this -- when Monarch
13 came into the account I have 5300 shares in July of 1969
14 valued at 20.5 dollars a share, or \$108,650. I have
15 here the following month, 9800 shares valued at 19-3/4 or
16 \$193,500.

17 In September of 1969, 9800 shares, at 17-5/8,
18 roughly \$173,000.

19 In October, 9800 shares valued at roughly
20 \$146,000.

21 In November, 1969, 9800 shares valued at
22 approximately \$147,000.

23 In December 1969, at about \$102,000 -- these are
24 all 9800 share lots.

25 January 1970, \$97,000.

February 1970, \$77,000.

March 1970, \$53,000.

April 1970, \$39,000.

May 1970, \$39,000.

June, \$42,000.

Q You don't have to go through that. Do you reflect a delivery of shares of Monarch free out of the account?

A Do I reflect a delivery free out of the account?

Q Yes.

A I would suppose some time I do, and it is no longer in the monthly statements.

Q What credit did you give in making calculations to the fact that certain securities were delivered out free?

A If they were not in the account they were never used as part of the average monthly value.

Q When they came in they were?

A Yes.

Q And they continued to be carried at that value until they were delivered out?

A They were carried at market value as long as they were in the account.

Q When they were delivered out free, what happened

1 A They were no longer valued, no longer carried
2
3 in the account.

4 Q In calculating your turnover rate it didn't
5 make any difference to you that the securities were delivered
6 out of the account free?

7 A It didn't make any difference? I could only
8 value the average monthly value in the account to compute
9 the turnover of the account. I can't put something that
10 is not in the account into a calculation of the turnover
11 rate.

12 Q M. J. Whitman & Co., Inc. is a broker-dealer and
13 you are the president?

14 A Yes.

15 Q How many registered representatives do you have
16 in your firm?

17 A Two, including myself.

18 Q One outside of yourself?

19 A Yes.

20 Q How many retail customers?

21 A I am just guessing, but I would say 100, 150.

22 Q How many non-retail customers?

23 A Twenty, maybe.

24 Q Does your firm act as an investment advisor
25 on a discretionary basis?

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A No.

Q Does it act as an investment advisor on any basis?

A A registered investment advisor, no.

Q How much of your time is spent in the preparation for test in securities litigation?

A That would be very difficult to say .

Q Over 50 per cent of your time?

A No.

Q Over 25?

A I bet that would be the ball park -- maybe a little high, but it is speculation on my part.

Q What is the arrangement you have in this case for compensation for your test?

A To be paid an hourly rate.

Q What is the rate?

A \$100.

Q I have shown you there the fourth edition of the book "Security Analysis," by Graham Dodd & Cottle. I ask you whether you agree that this book is authoritative in its field?

A I think my book is more authoritative but this is authoritative.

Q You will accept that as an authoritative treatise

Graham & Dodd?

A I guess I recognized. I think for the type book it is, it is probably as good as anything that has been done to date, if that answers your question.

Q Would you turn to page 47 of that book and tell me whether or not you would agree with the correctness of the statement contained in the second paragraph on that page which reads as follows:

"The first and most basic step in the formulation of a program for the acquisition and management of a security portfolio is to distinguish clearly between investment and speculation. As will be seen from the following, it is our view that security analysis is primarily useful to the investor and that it can perform only a limited service at best on the speculator's behalf."

Would you agree with that statement?

A No, I wouldn't.

Q You would not?

A No. I have written extensively on this subject and I think if you take it in the context in which they mean it, it has certain veracity, but basically I really don't agree with it.

Q You say that statement, in your view, is not correct?

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2 A Well, it is not the whole truth, put it that
3 way.

4 Q Would you say it is at least a half truth?

5 A It has meaningfulness in a very narrow context.

6 Q So you would say that for purposes of advising
7 a speculator you would use the same standards as you
8 would use with respect to an investor interested only in the
9 preservation of his capital?

10 A No.

11 MR. SILVERMAN: Objection, your Honor.

12 THE COURT: Sustained.

13 Q Is it your view that the standards and criteria
14 that you describe as the one you used on direct are suitable
15 for use where the objective of the investor is speculation
16 and not investment?

17 A Would the standards I used to identify quality
18 of issuers be useful --

19 Q The standards I referred to are your standards
20 of size, company seasoning, dividend record, earnings
21 record, market information; disclosure of facts and figures.

22 A What was the question about that?

23 Q Are those standards and criteria suitable for
24 use where the objective of the investor is speculation and
25 not the preservation of capital?

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A Yes, they are suitable but, understand, they just go to the quality of the issuer, they don't go to other things that would be in an investor's objectives as to whether he is speculating or not.

MR. KELLY: Would you read that answer back?
(Answer read.)

Q Perhaps I can approach it this way, Doctor: If a person is speculating, would it be fair to say one vehicle would be to invest in new issues?

A Yes.

Q New issues are not securities if they are entirely new that would fit the standards that you apply, would they, in the normal case?

A I am confused. An investor -- a speculator can speculate in any security, from U. S. Government bonds to Reg.A. offerings.

Q Would you say he should confine his investments within the standards and criteria that you used on direct?

A No.

Q Would you agree that with respect to such an investor the standards that you use are not the governing standards where speculation is involved?

A I don't know what the governing standards are that you are referring to. I would say --

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2 Q Would you agree that an investor interested
3 in speculation would in addition buy warrants?

4 A Sure.

5 Q Would he also involve himself in private place-
6 ments?

7 A That is another issue where we are talking about
8 outside passive investors --

9 Q I am talking about an investor who is interested
10 in speculation.

11 A Yes.

12 Q Would he also involve himself in venture
13 capital by getting founder's stock?

14 A I don't know that you can talk about outside
15 passive investors and then get into the whole area of non-
16 registered securities and especially founder's stock. If
17 somebody is buying true founder's stock, he is a promoter,
18 not an investor.

19 Q Do I understand you are saying to me your
20 definition of the outside passive investor doesn't encompass
21 and include one involved in speculation?

22 A No, by no means does that mean that.

23 MR. SILVERMAN: Your Honor, I think there
24 might be a double negative there that confuses me.

25 THE COURT: Do you want the question back?

1 THE WITNESS: Please.

2 (Question read.)

3 A My answer to that is outside passive investors
4 do speculate and are speculators.

5 Q If they are speculating, would they then
6 involve themselves only in the securities that measured up
7 to the standards that you applied with respect to size,
8 seasoning, earnings, etc.?

9 A No. I said an outside passive investor can
10 speculate in any security, and I think I mentioned Governmen
11 bonds.

12 Q I understand that. What I am asking is, if
13 his objective is speculation, would he be limited by the
14 standards that you used of size, seasoning, dividends,
15 earnings, market, and disclosure of information?

16 MR.SILVERMAN: If your Honor please, I think
17 we are talking about two different things, peaches and
18 pears. The question was how do you value various secur-
19 ities and the question is would an outside investor buy
20 lowest of the low, and they are not comparable. Mr.
21 Whitman's standards applied to grading Dr. Rolf's portfolio,
22 how many securities were in the lowest of the low, how many
23 low quality, etc., and now we are being asked would an
24 outside passive investor follow the criteria and he said
25

1 that he could invest in any number of things. There is
2 no nexus between his standards and what an outside
3 passive investor would invest in.
4

5 THE COURT: As it strikes me that could be so,
6 Mr. Kelly.

7 MR.KELLY: What I am seeking to establish, your
8 Honor, is that one who is interested in speculation involves
9 himself in securities that carry a greater degree of risk,
10 that with respect to an investor whose objective is the
11 preservation of capital, he uses another standard and I am
12 trying to get this witness, and I confess with no success
13 whatever, to acknowledge there are different standards by
14 which investors with different objectives would apply in
15 determining what is suitable to accomplish their objective
16 or attain the purposes they have in mind. I am aware
17 that Mr.Whitman persists in saying that whether or not you
18 are a wide-eyed speculator or a little old lady in tennis
19 shoes buying Government bonds that his standards are the
20 only ones that apply.

21 I am seeking to establish there is something
22 wrong with that test. If it is said I am not making a great
23 deal of success with that, I would quite agree, but
24 that is my point.

25 THE COURT: Well, the doctor of course has

1 stated that his primary objective at this stage, the
2 stage we are concerned about here, was the preservation
3 of his capital and the secondary objective was growth.
4

5 MR. KELLY: That was what he said, your Honor,
6 at one point. I think he has said something else else-
7 where, and it depends on which side you want to accept as
8 credible.

9 THE COURT: Well, it seems at least not logical.
10 He says he is 60-odd years old and in the early stages it
11 was a reverse of that, but in his later years he said he
12 switched those objectives.

13 MR. KELLY: I will withdraw the question, your
14 Honor.

15 Q In your historical tests of dividends and
16 earnings, to what extent are the expectations for the future
17 to be taken into account?

18 A They are not.

19 Q They are not?

20 A No.

21 Q So your test is purely historical? You look
22 at the earnings, let us say, for the past, and close your
23 eyes to the future?

24 A I don't know what you mean by my test. I am
25 asked to do the quality of issuers in a portfolio. I

1 tried to set up standards which were objective and would
2 not entail subjective judgments of the future or about
3 what other people thought these stocks were and were not,
4 and in setting up such standards, for quality of the issuer,
5 common standards, all you can rely on are objective initia
6 before you, you cannot speculate about what other people
7 think about the security or what somebody thinks or you
8 might think about the future outlook of the security.
9

10 It is a narrow test, what is the quality of the
11 issuer.

12 Q Am I correct in understanding that in applying
13 your tests and criteria you blind yourself to the earnings
14 of the future?

15 A My tests on quality of the issuer, yes.

16 Q Itake it, therefore, that your standards do
17 not utilize in any way the potential of a company for
18 growth?

19 A My standards as to objective tests of the
20 quality of the issuer do not use any tests of future growth.

21 Q In the application of the standards that you
22 have applied for an outside passive investor, am I correct
23 in saying the use of such standards is not suitable when
24 evaluating a private acquisition of restricted securities?

25 MR. SILVERMAN: May I have that read back?

1 I think we have the same double negative.

2 THE COURT: Yes.

3 (Question read.)

4 MR. SILVERMAN: Your Honor, I object. That
5 wasn't the witness' testimony, he has not said his stand-
6 ards --

7 THE COURT: Well, he can tell us that.

8 A The tests are obviously --

9 Q Can't you answer the question yes or no?

10 A No, there is no way to answer that question
11 yes or no. My goodness. The characteristics of the
12 issuer as to size you can apply as to standards. As to
13 standards as to the marketability of the security, of course
14 you cannot. If it is a private placement that came under
15 Section 4, say Rule 133 stock, there is no marketability
16 if there are no registration rights and I suppose you could
17 put in some tests as to potential marketability.

18 As to disclosure of information, I don't think
19 that there could conceivably be a disclosure in a private
20 placement to an outside passive investor who is in no
21 position to exercise due diligence unless the person doing
22 the private placement in fact sort of agrees to give
23 roughly the types of disclosure that would be required
24 were there to be a prospectus.
25

1
2 In terms of dividends paid and continual
3 profits, of course you could apply the same standards.
4 I guess that answers the question, yes and no, and that
5 it depends on the criterion you are looking at.

6 Q Would you apply the same yes and no if asked
7 with respect to a new issue under a prospectus?

8 A By "a new issue" you mean a company going pub-
9 lic for the first time?

10 Q Yes.

11 A Of course you could apply all the same stand-
12 ards except the one the date they first went public, which
13 would mean the issue was unseasoned, but I would think,
14 there in general the answer to the question is yes, you
15 could apply the same standards to quality of the issuer.

16 Q Am I correct in saying that your search dis-
17 closed no information or data with respect to Creative
18 Polymer?

19 A Not in Moody's manual and it was not in the
20 SEC directory.

21 Q Firefly?

22 A Firefly was apparently a filing company and I
23 did not order the materials. There would have been 10K
24 information available.

25 Q GPI?

1
2 A That goes to the quality of the security,
3 the availability of information. I am rating the quality
4 of the issuer from the viewpoint of the outside passive
5 investor. What I don't have, he doesn't have, and if he
6 doesn't have it, it is lowest of the low.

7 Q Regardless of the compliance with your other
8 standards?

9 A Correct.

10 Q With regard to the purchases of Dr. Rolf which
11 you examined, are you aware as to which of them were made
12 where a prospectus was received at or about the time of
13 the purchase?

14 A When I looked at the confirmations, if a pro-
15 spectus was sent with the confirmation, it was marked on
16 the confirmations. To respond specifically to your ques-
17 tion, I would have to go through each confirmation.

18 Q Do you know that Creative Polymer, Firefly and
19 Synchronex were purchased under a new issue prospectus?

20 A No, I don't.

21 Q Would you say if you had known that it would be
22 a different question as to whether or not there was public
23 information available?

24 A Yes.

25 Q If there was such a prospectus, then with

1
2 respect to the lack of data you would remove that as
3 a criticism?

4 A Yes, and then I would to the actual data
5 that would have existed for those companies.

6 Q But you didn't do that?

7 A Well, I guess the reason I didn't is, frankly,
8 if they were Mr. Yamada's securities, I knew they were
9 lowest of the low and would not have had any market because

10 MR. TESSLER: Objection, your Honor.

11 THE COURT: Sustained. Strike that.

12 MR. KELLY: Well, I would like that answer, your
13 Honor. It may be objectionable so far as the defendant
14 Yamada is concerned, but so far as I am concerned I don't
15 feel it is fair to strike it as against me because what
16 he is saying is that his standards were if Yamada bought
17 it, that is it, and the rest of it was a different story,
18 and I think to me it is a critical statement that I would
19 like not removed from this record. It may well be ob-
20 jectionable so far as Yamada or not, but that I have
21 nothing to do with.

22 THE COURT: It may be that you have an idea
23 of what his answer is going to be and it seems to me you
24 can frame a question to elicit it in terms of getting
25 you what you want and yet not spread on the record his

speculation about something.

Q Do you know whether or not there were prospectuses that accompanied the transactions in M.H. Studios TeleCommunications, International Health Sciences, Visual Sciences and Holobeam?

A I do.

Q If there were such prospecti, would you again state then with respect to the lack of data you would be incorrect?

A Well, no.

Q Are you saying that a prospectus would not be sufficient data to comply with your tests?

A I am saying the lack of the -- I had three criteria, Moody's, Standard & Poor's Stock Guide, and SEC filing, and I would be correct that those were not disclosed. That I could have that -- someone contemporaneously could have obtained information about the issuer and the market, and so forth, in my objective test from the prospectus, they certainly could have contemporaneously at that time. In that sense it is certainly correct to say where a prospectus was issued, information would have been available.

MR. TESSLER: Could I ask to have that answer read back, please.

1 THE COURT: All right.

2 (Answer read.)

3 Q Assuming that with respect to Creative Polymer,
4 Firefly and Synchronex, they were made under a prospectus
5 and you would say it then met your public data test?
6

7 A It met a public data test. As I explained, my
8 test was these three types of publications.

9 Q I thought you had conceded that the prospectus
10 would be an additional adequate substitute for the ones
11 you used?

12 A We may be toying with words. I said it would
13 meet ~~a~~ test and you asked would it meet my test, and
14 my test happened to be Moody's, Standard & Poor's and the
15 10K filings.

16 Q I thought your test was public disclosure.

17 A Yes, a test.

18 Q I am talking about that one test.

19 A Test in general, yes, a prospectus would
20 have met that.

21 Q Why did you find Creative Polymer to be lowest
22 of the low?

23 A (1), because I did not know there were any
24 public disclosures, because I looked at the material
25 available to me.

1
2 Q If you had known there was a prospectus, would
3 it have made a difference?

4 A I would have gotten the prospectus, yes.

5 Q Would your opinion with respect to the quality
6 be different?

7 A Very probably not.

8 Q Why?

9 A Two or three years ago in connection with some
10 of my own investment activities I had occasion to read --
11 I think it would be in 1973 -- I believe it was the SEC
12 indictment in connection with certain Yamada matters,
13 where I think virtually every one of these securities was
14 mentioned, and so in a general sense I knew, without the
15 specific statistics, something about the quality of these
16 issues.

17 Q In other words, you --

18 MR. TESSLER: Your Honor, could I have that
19 answer read back?

20 THE COURT: Yes.

21 (Answer read.)

22 MR. TESSLER: Your Honor, I move to strike
23 that answer as against my client. It is not responsive,
24 is irrelevant, biased, prejudicial.

25 THE COURT: Overruled.

1
2 Q Am I correct in understanding that with
3 respect to your quality rating you took into account the
4 facts that you knew about Mr. Yamada so far as you found
5 them either in the papers or the SEC reports?

6 A No, that is not completely true, except as to
7 what I have just testified to, and I should supplement
8 that answer by saying --

9 MR. KELLY: I will ask your Honor's help on
10 this one. I don't think this is fair. I think there
11 is a clearcut, direct answer to my question, and it is yes
12 or no.

13 THE COURT: Just a moment. Read the question
14 back, please.

15 (Question read.)

16 THE COURT: Either in the papers or the SEC
17 reports, "papers" meaning --

18 MR. KELLY: I will add to that question "or
19 otherwise."

20 THE COURT: He has answered the question.
21 His answer is yes, to some extent, he did do exactly
22 that.

23 Is that your answer?

24 THE WITNESS: That is one of two ways I could
25 have known about the quality of the issuers when I --

1 THE COURT: That is going off into further
2 explanation that he has not inquired about. The answer
3 is "to some extent, I did"? Isn't that it?
4

5 THE WITNESS: Yes.

6 Q Do you know when that information to which
7 you looked first became public knowledge?

8 A I wouldn't know.

9 Q Did you know it came into public knowledge
10 after the acquisition of these 15 securities?

11 A I wouldn't know.

12 Q Your conclusion that these 15 securities were
13 not suitable for Dr. Rolf were in part conditioned and
14 premised upon the fact of what you knew about Mr. Yamada,
15 is that correct?

16 A In part conditioned upon the securities I knew
17 Mr. Yamada was investing in and in part in view of the
18 statistics I gathered and in part in view of the facts
19 that there was no disclosure in recognized statistical sources.

20 Q I think you said in part you took into account
21 what you knew about Yamada in determining whether or not
22 the security was suitable for Dr. Rolf?

23 A To be specific --

24 Q Just be specific.

25 A I knew from the indictment the class of

1 securities in which Mr. Yamada was investing.

2
3 Q And it was as a result of that knowledge, in
4 part, that you made the judgment with respect to the
5 suitability of these securities for Dr. Rolf?

6 A Yes.

7 Q On your direct examination you expressed
8 the opinion that the 15 securities you then identified were
9 unsuitable for one whose investment objective was the pre-
10 servation of capital and the investing of such capital
11 by taking reasonably prudent risks. If you were to
12 assume an investor whose investment objective was to
13 accomplish in one year an increase in the opening value
14 of securities of \$2 million to a value at the end of that
15 year of between three and one-half to \$5 million, would
16 that assumption change your opinion as to what was a suit-
17 able security for such an investor?

18 MR. SILVERMAN: Objection, your Honor.

19 THE COURT: Overruled. Did you follow the
20 question?

21 THE WITNESS: Yes, I did.

22 A Let me say, I have never met an investor who
23 had just one single-minded objective. Any investor who
24 had as part of his goal any type of safety factor and not
25 just the one single goal of "doubling my money in six

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2 months or one year," this would be unsuitable.

3 Q You are saying that whether or not the investor
4 objective was the preservation of capital and the
5 increase by taking reasonable, prudent risks, was to
6 within one year increase his two million to three and a hal
7 to five, the standards that you used would uniformly be
8 applicable to both?

9 A I don't really follow that, Mr. Kelly.

10 Q Do I correctly understand you to say that
11 the standards that you have set up, the criterion you
12 established, would be equally applicable to investor A,
13 whose objective is the preservation of capital and the
14 increase in such capital by taking reasonably prudent
15 risks and is now less and is equally applicable to investor
16 B, who having two million dollars worth of securities
17 seeks to increase it to three and a half to \$5 million in
18 one year?

19 A Oh, I would think those two different investors
20 with different objectives, you have to apply different
21 standards.

22 Q Have you an opinion of the investment quality
23 of the security of Dasa Corporation? It is not on your
24 schedule, sir.

25 A I beg to differ.